Internal Revenue
bulletin

Bulletin No. 2001–23
June 4, 2001

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. 2001–26, page 1297.
Two-step stock acquisitions. Certain two-step stock acquisitions comprised of a tender offer and a merger qualify as reorganizations under sections 368(a)(1)(A) and 368(a)(2)(E) of the Code.

Rev. Rul. 2001–27, page 1298.
Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for June 2001.

Rev. Proc. 2001–37, page 1327.
This procedure provides guidance to taxpayers regarding certain elections made pursuant to the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ("the Act"). Specifically, this revenue procedure includes guidance with respect to the election to exclude gross receipts from foreign trading gross receipts under section 942(a)(3) of the Code, the election (and revocation of such election) by a foreign corporation to be treated as a domestic corporation under section 943(e)(1) of the Code, and the election (and revocation of such election) by a taxpayer to apply the extraterritorial income exclusion in lieu of the foreign sales corporation ("FSC") provisions to certain transactions under section 5(c)(2) of the Act.

EXCISE TAX

T.D. 8945, page 1300.
Final regulations under section 4081 of the Code revise the rules relating to taxable fuel measurement. Notice 2000–33 obsolete.

ADMINISTRATIVE

Notice 2001–34, page 1302.
Annual accounting periods; approval. This notice provides a proposed revenue procedure that, when finalized, will provide the procedures under section 442 of the Code to establish a business purpose and request the approval of the Commissioner to adopt, change, or retain a taxpayer's annual accounting period.

Notice 2001–35, page 1314.
Annual accounting periods; automatic approval. This notice provides a proposed revenue procedure that, when finalized, will provide the procedures for certain partnerships, S corporations, electing S corporations, and personal service corporations to obtain automatic approval of the Commissioner to adopt, change, or retain their annual accounting periods.

Rev. Proc. 2001–33, page 1322.
Administrative appeal of dyed fuel and refusal penalties. This procedure explains how to request an administrative appeal of the penalties imposed by section 6715 of the Code, relating to the misuse of dyed diesel fuel and kerosene, and by sections 4083(c)(3) and 7342 of the Code, relating to the refusal to admit entry for purposes of inspecting facilities and equipment and taking and removing fuel samples.

Rev. Proc. 2001–36, page 1326.
This procedure grants automatic permission for certain securities partnerships to aggregate the built-in gains and losses from contributed property for purposes of making allocations under section 704(c) of the Code.

Announcement 2001–59, page 1331.
This document contains corrections to Rev. Proc. 2001–26 (2001–17 I.R.B. 1093) relating to the general rules and specifications for the private printing of substitute Forms W-2 and W-3.

Finding Lists begin on page ii.
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Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

Part 1100.—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.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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.

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, page 1298.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, page 1298.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

Two-step stock acquisitions. The ruling holds that certain two-step stock acquisitions comprised of a tender offer and a merger quailify as reorganizations under sections 368(a)(1)(A) and 368(a)(2)(E).

Rev. Rul. 2001–26

ISSUE

On the facts described below, is the control-for-voting-stock requirement of § 368(a)(2)(E) of the Internal Revenue Code satisfied, so that a series of integrated steps constitutes a tax-free reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E) and § 354 or § 356 applies to each exchanging shareholder?

FACTS

Situation 1. Corporation P and Corporation T are widely held, manufacturing corporations organized under the laws of state A. T has only voting common stock outstanding, none of which is owned by P. P seeks to acquire all of the outstanding stock of T. For valid business reasons, the acquisition will be effected by a tender offer for at least 51 percent of the stock of T, to be acquired solely for P voting stock, followed by a merger of a subsidiary of P into T. P initiates a tender offer for T stock conditioned on the tender of at least 51 percent of the T shares. Pursuant to the tender offer, P acquires 51 percent of the T stock from T's shareholders for P voting stock. P forms S and S merges into T under the merger laws of state A. In the statutory merger, P's S stock is converted into T stock and each of the T shareholders holding the remaining 49 percent of the outstanding T stock exchanges its shares of T stock for a combination of consideration, two-thirds of which is P voting stock and one-third of which is cash. Assume that under general principles of tax law, including the step transaction doctrine, the tender offer and the statutory merger are treated as an integrated acquisition by P of all of the T stock. Also assume that all nonstatutory requirements for a reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E) and all statutory requirements of § 368(a)(2)(E), other than the requirement under § 368(a)(2)(E)(ii) that P acquire control of T in exchange for its voting stock in the transaction, are satisfied.

Situation 2. The facts are the same as in *Situation 1*, except that S initiates the tender offer for T stock and, in the tender offer, acquires 51 percent of the T stock for P stock provided by P.

LAW AND ANALYSIS

Section 368(a)(1)(A) states that the term "reorganization" means a statutory merger or consolidation. Section 368(a)(2)(E) provides that a transaction otherwise qualifying under § 368(a)(1)(A) will not be disqualified by reason of the fact that stock of a corporation (the "controlling corporation") that before the merger was in control of the merged corporation is used in the transaction, if (1) after the transaction, the corporation surviving the merger holds substantially all of its properties and of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction), and (2) in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation that constitutes control of such corporation (the "control-for-voting-stock requirement"). For this purpose, control is defined in § 368(c).

In *King Enterprises, Inc. v. United States*, 418 F.2d 511 (Ct. Cl. 1969), as part of an integrated plan, a corporation acquired all of the stock of a target corporation from the target corporation's shareholders for consideration, in excess of 50 percent of which was acquiring corporation stock, and subsequently merged the target corporation into the acquiring corporation. The court held that, because the merger was the intended result of the stock acquisition, the acquiring corporation's acquisition of the target corporation qualified as a reorganization under § 368(a)(1)(A).

Section 354(a)(1) provides that no gain or loss will be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in another corporation a party to the reorganization.

Section 356(a)(1) provides that, if § 354 would apply to the exchange except for the receipt of money or property other than stock or securities in a corporate party to the reorganization, the recipient shall recognize gain, but in an amount not in excess of the sum of the money and the fair market value of the other property.

Section 1.368–1(c) of the Income Tax Regulations provides that a plan of reorganization must contemplate the *bona fide* execution of one of the transactions specifically described as a reorganization in § 368(a) and the *bona fide* consummation of each of the requisite acts under which nonrecognition of gain is claimed. Section 1.368–2(g) provides that the term plan of reorganization is not to be construed as broadening the definition of reorganization as set forth in § 368(a), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges or distributions as are directly a part of the transaction specifically described as a reorganization in § 368(a).

As assumed in the facts, under general principles of tax law, including the step transaction doctrine, the tender offer and the statutory merger in both *Situations 1 and 2* are treated as an integrated acquisition by P of all of the T stock. The principles of *King Enterprises* support the conclusion that, because the tender offer is integrated with the statutory merger in

both *Situations 1 and 2*, the tender offer exchange is treated as part of the statutory merger (hereinafter the "Transaction") for purposes of the reorganization provisions. *Cf. J.E. Seagram Corp. v. Commissioner*, 104 T.C. 75 (1995) (treating a tender offer that was an integrated step in a plan that included a forward triangular merger as part of the merger transaction). Consequently, the integrated steps, which result in P acquiring all of the stock of T, must be examined together to determine whether the requirements of § 368(a)(2)(E) are satisfied. *Cf.* § 1.368–2(j)(3)(i); § 1.368–2(j)(6), Ex. 3 (suggesting that, absent a special exception, steps that are prior to the merger, but are part of the transaction intended to qualify as a reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E), should be considered for purposes of determining whether the control-for-voting-stock requirement is satisfied).

In both situations, in the Transaction, the shareholders of T exchange, for P voting stock, an amount of T stock constituting in excess of 80 percent of the voting stock of T. Therefore, the control-for-voting-stock requirement is satisfied. Accordingly, in both *Situations 1 and 2*, the Transaction qualifies as a reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E).

Under §§ 1.368–1(c) and 1.368–2(g), all of the T shareholders that exchange their T stock for P stock in the Transaction will be treated as exchanging their T stock for P stock in pursuance of a plan of reorganization. Therefore, T shareholders that exchange their T stock only for P stock in the Transaction will recognize no gain or loss under § 354. T shareholders that exchange their T stock for P stock and cash in the Transaction will recognize gain to the extent provided in § 356. In both *Situations 1 and 2*, none of P, S, or T will recognize any gain or loss in the Transaction, and P's basis in the T stock will be determined under § 1.358–6(c)(2) by treating P as acquiring all of the T stock in the Transaction and not acquiring any of the T stock before the Transaction.

HOLDING

On the facts set forth in *Situations 1 and 2*, the control-for-voting-stock requirement is satisfied in the Transaction, the Transaction constitutes a tax-free reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E), and § 354 or § 356 applies to each exchanging shareholder.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Marnie Rapaport and Joseph M. Calianno of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Ms. Rapaport at (202) 622-7550 (not a toll-free call) or Mr. Calianno at (202) 622-7930 (not a toll-free call).

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

The adjusted applicable federal long-term rate is set forth for the month of June 2001. See Rev. Rul. 2001–27, beginning on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, beginning on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, beginning on this page.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, beginning on this page.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, beginning on this page.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, beginning on this page.

Section 704(c).—Contributed Property

26 CFR 1.704–3: Contributed property.

Can a Qualified Master Feeder-Structure aggregate built-in gains and losses from contributed securities for purposes of making section 704(c) and reverse section 704(c) allocations? See Rev. Proc. 2001–36, page 1326.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, beginning on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, beginning on this page.

Section 942.—Foreign Trading Gross Receipts

This revenue procedure addresses elections under sections 942 and 943 of the Internal Revenue Code and under section 5(c)(2) of Pub. L. No. 106–519, 114 Stat. 2423. See Rev. Proc. 2001–37, page 1327.

Section 943.—Other Definitions and Special Rules

This revenue procedure addresses elections under sections 942 and 943 of the Internal Revenue Code and under section 5(c)(2) of Pub. L. No. 106–519, 114 Stat. 2423. See Rev. Proc. 2001–37, page 1327.

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

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

Federal rates; adjusted federal rates; adjusted federal long-term rate, and

the long-term exempt rate. For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for June 2001.

Rev. Rul. 2001–27

This revenue ruling provides various prescribed rates for federal income tax purposes for June 2001 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2001–27 TABLE 1

Applicable Federal Rates (AFR) for June 2001

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	4.15%	4.11%	4.09%	4.08%
110% AFR	4.57%	4.52%	4.49%	4.48%
120% AFR	4.99%	4.93%	4.90%	4.88%
130% AFR	5.41%	5.34%	5.30%	5.28%
Mid-Term				
AFR	5.02%	4.96%	4.93%	4.91%
110% AFR	5.53%	5.46%	5.42%	5.40%
120% AFR	6.04%	5.95%	5.91%	5.88%
130% AFR	6.55%	6.45%	6.40%	6.36%
150% AFR	7.58%	7.44%	7.37%	7.33%
175% AFR	8.87%	8.68%	8.59%	8.53%
Long-Term				
AFR	5.75%	5.67%	5.63%	5.60%
110% AFR	6.34%	6.24%	6.19%	6.16%
120% AFR	6.92%	6.80%	6.74%	6.71%
130% AFR	7.51%	7.37%	7.30%	7.26%

REV. RUL. 2001–27 TABLE 2

Adjusted AFR for June 2001

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.46%	3.43%	3.42%	3.41%
Mid-term adjusted AFR	3.99%	3.95%	3.93%	3.92%
Long-term adjusted AFR	5.01%	4.95%	4.92%	4.90%

REV. RUL. 2001–27 TABLE 3

Rates Under Section 382 for June 2001

Adjusted federal long-term rate for the current month	5.01%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.01%

REV. RUL. 2001–27 TABLE 4	
Appropriate Percentages Under Section 42(b)(2) for June 2001	
Appropriate percentage for the 70% present value low-income housing credit	8.26%
Appropriate percentage for the 30% present value low-income housing credit	3.54%

REV. RUL. 2001–27 TABLE 5	
Rate Under Section 7520 for June 2001	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	6.0%

Section 1288.—Treatment of Original Issue Discounts of Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, page 1298.

Section 4081.—Imposition of Tax

26 CFR 48.4081–8: Taxable fuel; measurement.

T.D. 8945

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 48

Taxable Fuel Measurement

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the measurement of taxable fuel. The regulations affect certain blenders, enterers, refiners, terminal operators, and throughputters.

DATES: *Effective Date*: These regulations are effective May 18, 2001.

Applicability Date: These regulations are applicable January 1, 1994.

FOR FURTHER INFORMATION CONTACT: Frank Boland (202) 622-3130 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 4081 imposes a tax on certain removals, entries, and sales of taxable fuel. Section 4083 provides that taxable fuel means gasoline, diesel fuel, and kerosene.

Before July 1, 2000, regulations provided that gallons of taxable fuel could be measured on the basis of actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit. However, regulations that were published in the **Federal Register** on March 31, 2000 (T.D. 8879; 65 FR 17149), provide that beginning July 1, 2000, for each period from July 1 through the following June 30 a person liable for tax on a removal may use only one of the two bases of measurement with respect to taxable fuel removed from any particular terminal, refinery, or blending facility. This rule (the consistency requirement) also applies to taxable entries and sales.

After publication of T.D. 8879 (2000–16 I.R.B. 882), the IRS and the Treasury Department determined that many taxpayers would have had to change their accounting systems to comply with the consistency requirement and would have been unable to complete the necessary changes by July 1, 2000. Accordingly, Notice 2000–33 (2000–27 I.R.B. 97) provided that taxpayers would not be required to comply with the consistency requirement before July 1, 2001. In the meantime, a taxpayer could use either basis of measurement for each taxable removal, entry, or sale of taxable fuel.

Explanation of Provisions

The IRS and the Treasury Department have now determined that the consistency requirement would force many taxpayers to alter current standard business practices and potentially could make routine IRS examinations more time consuming and burdensome. To avoid these adverse consequences, the final regulations in this document remove the consistency requirement and reinstate the provision that was in effect before July 1, 2000.

Effect on Other Documents

Notice 2000–33 (2000–27 I.R.B. 97) is obsolete as of May 18, 2001.

Special Analyses

This rule relieves taxpayer burden by eliminating a requirement with respect to the measurement of taxable fuel. Therefore, it has been determined that notice and public comment are unnecessary and contrary to the public interest. For the same reason, a delayed effective date under 5 U.S.C. 553(d) is not required. Because no preceding notice of proposed rulemaking is required for this Treasury decision and the rule does not impose on small entities a collection of information requirement, the provisions of the Regulatory Flexibility Act do not apply. It also 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. Pursuant to section 7805(f) of the Code, these final regulations were 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 Frank Boland, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 48 is amended as follows:

PART 48–MANUFACTURERS AND RETAILERS EXCISE TAXES

Paragraph 1. The authority citation for part 48 continues to read in part as follows:

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

Par. 2. Section 48.4081–8 is revised to read as follows:

§48.4081–8 Taxable fuel; measurement.

(a) *In general*. Volumes of taxable fuel may be measured on the basis of actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit.

(b) *Effective date*. This section is applicable January 1, 1994.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved May 10, 2001.

Mark A. Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 17, 2001, 8:45 a.m., and published in the issue of the Federal Register for May 18, 2001, 66 F.R. 27597)

Section 4083.—Definitions; Special Rule; Administrative Authority

26 CFR 48.4083–1: Taxable fuel: administrative authority.

Administrative Appeal of Dyed Fuel and Refusal Penalties. This revenue procedure explains how to request an administrative appeal of the penalties imposed by § 6715, relating to the misuse of dyed diesel fuel and kerosene, and §§ 4083(c)(3) and 7342, relating to the refusal to admit entry for purposes of inspecting facilities and equipment and taking and removing fuel samples. See Rev. Proc. 2001–33, page 1322.

Section 6715.—Dyed Fuel Sold for Use or Used in Taxable Use

Administrative Appeal of Dyed Fuel and Refusal Penalties. This revenue procedure explains how to request an administrative appeal of the penalties imposed by § 6715, relating to the misuse of dyed diesel fuel and kerosene, and §§ 4083(c)(3) and 7342, relating to the refusal to admit entry for purposes of inspecting facilities and equipment and taking and removing fuel samples. See Rev. Proc. 2001–33, page 1322.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, page 1298.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001–27, page 1298.

Part III. Administrative, Procedural, and Miscellanous

Procedures for Requesting an Adoption, Change, or Retention of Accounting Period

Notice 2001–34

This notice provides a proposed revenue procedure that, when finalized, will provide the procedures under § 442 of the Internal Revenue Code, and the regulations thereunder, to establish a business purpose and request the approval of the Commissioner to adopt, change, or retain a taxpayer's annual accounting period. The proposed revenue procedure will apply to taxpayers that are outside the scope of the revenue procedures that provide for automatic approval to adopt, change, or retain an annual accounting period. *See, e.g.,* Rev. Proc. 2000–11, 2000–3, I.R.B. 309; Notice 2001–35, 2001–23 I.R.B 1314, and Rev. Proc. 66–50, 1966–2 C.B. 1260. This proposed revenue procedure is being issued concurrently with new proposed regulations under §§ 441, 442, 706 and 1378, and a proposed revenue procedure (Notice 2001–35, 2001–23 I.R.B.) updating Rev. Proc. 87–32, 1987–2 C.B. 396, which will provide procedures under which a partnership, S corporation, electing S corporation, or PSC may obtain automatic approval to adopt, retain, or change its annual accounting period. References in this proposed revenue procedure to the regulations under §§ 441, 442, 706, and 1378 are to the new proposed regulations, and references to "Rev. Proc. 2001–XX" are to the proposed revenue procedure updating Rev. Proc. 87–32. All three documents are intended to be finalized concurrently.

Under its current ruling practice, the Internal Revenue Service weighs the merits of a taxpayer's stated business purpose for the requested annual accounting period against the amount of distortion of income or other tax consequences resulting from the adoption of, change to, or retention of that annual accounting period. In general, the only circumstance in which the Service has determined that a taxpayer's business purpose overcomes more than *de minimis* distortion of income is where the taxpayer is adopting, changing to, or retaining, its natural business year. In any other case, such as where a taxpayer is requesting to change its annual accounting period to conform to its financial reporting period, the taxpayer generally has been denied approval to use an annual accounting period that results in more than *de minimis* distortion of income.

Under the proposed revenue procedure, the Service in its ruling practice would no longer weigh the merit of a taxpayer's stated business purpose against the amount of distortion of income. Taxpayers wanting to adopt, change to, or retain a natural business year generally would be granted approval under the proposed revenue procedure (provided they agree to general terms and conditions) as under the current IRS ruling practice. Also consistent with the current IRS ruling practice, establishing a natural business year generally will be the only circumstance under which a partnership, S corporation, electing S corporation, or PSC will be granted approval. However, the IRS ruling practice for other taxpayers generally will be liberalized. These other taxpayers that do not establish a natural business year generally would be granted approval under the proposed revenue procedure if they agree to certain additional terms, conditions, and adjustments designed to neutralize the tax effects of substantial distortion of income resulting from the change. Under the Service's current ruling practice, these other taxpayers generally would have been denied approval to change their annual accounting period if the change would have resulted in more than *de minimis* distortion of income.

The proposed revenue procedure provides audit protection to taxpayers adopting, changing, or retaining an annual accounting period under the revenue procedure. In conjunction with the provision of audit protection, taxpayers under examination that do not obtain consent of the appropriate director are not within the scope of the proposed revenue procedure. The Service and Treasury Department specifically request comments regarding whether the benefits of providing audit protection outweigh the burden on taxpayers under examination of having to obtain a director's consent, particularly with respect to C corporations which generally would not benefit from audit protection but still would be required to obtain a director's consent if under examination.

The Service also welcomes other comments on the proposed revenue procedure provided in this notice. Comments should be submitted by September 11, 2001, either to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
Attn: CC:PA:T:CRU (ITA)
Room 5228

or electronically via:

Notice.Comments@m1.irscounsel.treas.gov (the Service Comments e-mail address).

Rev. Proc. 2001–XX

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DRAFTING INFORMATION

SECTION 1. PURPOSE

This revenue procedure provides the general procedures under § 442 of the Internal Revenue Code and § 1.442–1(b) of the Income Tax Regulations for establishing a business purpose and obtaining the approval of the Commissioner of Internal Revenue to adopt, change, or retain an annual accounting period for federal income tax purposes. This revenue procedure also describes the terms, conditions, and adjustments that the Commissioner may deem necessary to effect the adoption, change, or retention.

SECTION 2. BACKGROUND

.01 *Taxable year defined*.

(1) *In general*. Section 441(b) and § 1.441–1(b)(1) of the regulations provide that the term "taxable year" generally means the taxpayer's annual accounting period, if it is a calendar or fiscal year, or, if applicable, the taxpayer's required taxable year.

(2) *Annual accounting period*. Section 441(c) and § 1.441–1(b)(3) provide that the term "annual accounting period" means the annual period (calendar year or fiscal year) on the basis of which the taxpayer regularly computes its income in keeping its books.

(3) *Required taxable years*. Section 1.441–1(b)(2) provides that certain taxpayers must use the particular taxable year that is required under the Code and the regulations thereunder (the "required taxable year"). For example, a partnership, S corporation, electing S corporation, or personal service corporation (PSC) has a required taxable year that generally conforms to the taxable years of its partners, shareholders, or employee-owners pursuant to §§ 706(b), 1378, and 441(i), respectively. Similarly, a specified

foreign corporation has a required taxable year that generally represents the taxable year of its majority U.S. shareholder pursuant to § 898. However, § 1.441–1(b)(2)(ii) describes exceptions under which certain taxpayers may use a taxable year other than their required taxable year. For example, a partnership, S corporation, electing S corporation, or PSC may have a taxable year other than its required taxable year if it elects to use a 52–53-week taxable year that references its required taxable year, makes an election under § 444, or establishes a business purpose and obtains approval under § 442 for that taxable year. *See also* §§ 706(b), 1378, and 441(i).

.02 *Adoption of taxable year*. Generally, a taxpayer may adopt any taxable year that satisfies § 441 and the regulations thereunder without the approval of the Commissioner. However, a partnership, electing S corporation, or PSC that wants to adopt a taxable year other than its required taxable year, a 52–53-week taxable year that references its required taxable year, or a taxable year elected under § 444, must establish a business purpose and obtain approval under § 442. *See* § 1.441–1(c).

.03 *Change in taxable year*.

(1) *In general*. Section 1.442–1(a)(1) generally provides that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain approval from the Commissioner.

(2) *Annualization of short period return*. Section 443(b) and § 1.443–1(b)(1)(i) generally provide that if a return is made for a short period resulting from a change of an annual accounting period, the taxable income for the short period must be placed on an annual basis by multiplying the income by 12 and dividing the result by the number of months in the short period. Unless § 443(b)(2) and § 1.443–1(b)(2) apply, the tax for the short period is the same part of the tax computed on an annual basis as the number of months in the short period is of 12 months. *See* § 1.706–1(b)(4)(i) for an exception for partnerships.

(3) *No retroactive change in annual accounting period*. Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in annual accounting period, regardless of whether the change is to a required taxable year.

.04 *Retention of taxable year*. In certain cases, a partnership, S corporation, electing S corporation, or PSC will be required to change its taxable year unless it establishes a business purpose and obtains the approval of the Commissioner under § 442, or makes an election under § 444, to retain its current taxable year. *See* § 1.441–1(d). For example, a corporation with a June 30 fiscal year that either becomes a PSC or elects to be an S corporation, and as a result is required to use the calendar year, must obtain the approval of the Commissioner to retain its current fiscal year. Similarly, a partnership using a taxable year that corresponds to its required taxable year generally must obtain the approval of the Commissioner to retain that taxable year if its required taxable year changes as a result of a change in ownership. *But see* § 706(b)(2)(B).

.05 *Approval of an adoption, change, or retention*.

(1) *In general*. Section 1.442–1(b) provides that in order to secure approval to adopt, change, or retain an annual accounting period, a taxpayer must file an application generally on Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, with the Commissioner no earlier than the day following the close of the first taxable year in which the taxpayer wants the change to be effective (the first effective year) and no later than the 15th day of the third calendar month following the close of the first effective year. In general, an adoption, change, or retention in annual accounting period will be approved where the taxpayer establishes a business purpose for the requested annual accounting period and agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the adoption, change, or retention.

(2) *Automatic approval*. Under the Code and regulations, certain taxpayers are allowed to change their annual accounting periods without approval or with automatic approval (*see, e.g.,* § 859(b), § 1.442–1(c) and (d), and § 1.706–1T(c)). In addition, the Service has issued revenue procedures that enable certain taxpayers to obtain automatic approval to adopt, change, or retain their annual accounting periods. *See, for example,* Rev. Proc. 2000–11, 2000–3 I.R.B. 309 (or any successor) for corporations; Rev. Proc. 2001– XX, [insert cite] (or any successor) for partnerships, S corporations, electing S corporations, and PSCs; and Rev. Proc. 66–50, 1966–2 C.B. 1260 (or any successor) for individuals.

.06 *Business purpose*.

(1) *In general*. Section 1.442–1(b) provides that in determining whether a taxpayer has established a business purpose and which terms, conditions, and adjustments will be required, consideration will be given to all the facts and circumstances relating to the adoption, change, or retention, including the tax consequences resulting therefrom. *See also* H.R. Rep. No. 99–841, 99th Cong., 2d Sess., II–318, 1986–3 (Vol. 4) C.B. 319.

(2) *Sufficient business purposes*. Section 1.442–1(b) provides that generally the requirement of a business purpose will be satisfied, and adjustments to neutralize any tax consequences will not be required, if the requested annual accounting period coincides with the taxpayer's natural business year. A taxpayer generally is deemed to have established a natural business year if it satisfies the 25-percent gross receipts test provided in section 5.04 of Rev. Proc. 2001–XX, [insert cite]. In Rev. Rul. 87–57, 1987–2 C.B. 117, the Service determined that a partnership, S corporation, or PSC established, to the satisfaction of the Secretary, a business purpose for adopting, retaining, or changing its taxable year in the following four situations:

(a) the taxpayer established that the taxable year satisfied the 25-percent gross receipts test and resulted in less deferral than its natural business year;

(b) the taxpayer would have established a natural business year under the 25-percent gross receipts test, except that a labor strike closed the taxpayer's business during a period that included its normal peak season;

(c) the taxpayer, for the past 10 years, had a three-month period of insignificant gross receipts during which, due to weather conditions, its business was not operational; and

(d) the taxpayer, which previously used the cash receipts and disbursements method and changed to an accrual method, would have established a natural business year under the 25-percent gross

receipts test if it had calculated its gross receipts under an accrual method.

(3) *Insufficient business purposes*. Section 1.442–1(b) provides that, in the case of a partnership, S corporation, electing S corporation, or PSC, deferral of income to partners, shareholders, or employee-owners will not be treated as a business purpose for using a taxable year other than its required taxable year. In addition, the legislative history to the Tax Reform Act of 1986 provides that the following reasons ordinarily will not be sufficient for a partnership, S corporation, or PSC to establish that the business purpose requirement for a particular taxable year has been met:

(a) the use of a particular year for regulatory or financial accounting purposes;

(b) the hiring patterns of a particular business, *e.g.*, the fact that a firm typically hires staff during certain times of the year;

(c) the use of a particular year for administrative purposes, such as the admission or retirement of partners or shareholders, promotion of staff, and compensation or retirement arrangements with staff, partners, or shareholders; and

(d) the fact that a particular business involves the use of price lists, model years, or other items that change on an annual basis.

Although the above items are not themselves sufficient to establish a business purpose, they may be considered in connection with other items by the Commissioner in determining whether a taxpayer has a business purpose for a particular taxable year. H.R. Rep. No. 99–841, 99th Cong., 2d Sess., II–318, 1986–3 (Vol. 4) C.B. 319

.07 *Section 444 elections*. Section 444 generally allows certain partnerships, S corporations, electing S corporations, and PSCs to elect a taxable year other than their required taxable year if the deferral period of the new taxable year is three months or less. Partnerships and S corporations with § 444 elections must make required payments under § 7519 that approximate the amount of the deferral benefit and PSCs with § 444 elections are subject to the minimum distribution requirements of § 280H. A taxpayer may automatically adopt, change to, or retain a taxable year permitted by § 444 by filing a Form 8716, *Election to Have a Taxable Year Other Than a Required Taxable Year*. A taxpayer that wants to terminate its § 444 election must follow the automatic procedures under § 1.444–1T(a)(5) to change to its required taxable year or establish a business purpose for its taxable year pursuant to § 442 and this revenue procedure.

SECTION 3. SCOPE

.01 *Applicability*. Except as provided in section 3.02 of this revenue procedure, this revenue procedure applies to any taxpayer requesting the Commissioner's approval to adopt, change, or retain an annual accounting period for federal income tax purposes.

.02 *Inapplicability*. This revenue procedure does not apply to:

(1) *Automatic approval*. An adoption, change, or retention in annual accounting period that is permitted to be made pursuant to a provision in the Code or regulations or a published automatic approval procedure. Before submitting an application pursuant to this revenue procedure, taxpayers are encouraged to review the automatic approval procedures referenced in § 1.442–1 and the following revenue procedures: Rev. Proc. 2000–11 (for corporations); Rev. Proc. 2001–XX (for partnerships, S corporations, electing S corporations, and PSCs); Rev. Proc. 66–50, as modified by Rev. Proc. 81–40, 1981–2 C.B. 604 (for individuals); Rev. Proc. 85–58, 1985–2 C.B. 740, and Rev. Proc. 76–10, 1976–1 C.B. 548, as modified by Rev. Proc. 79–3, 1979–1 C.B. 483 (for exempt organizations); Rev. Proc. 87–27, 1987–1 C.B. 769 (for employee retirement plans and employee trusts); and Rev. Proc. 85–15, 1985–1 C.B. 516 (for changes to comply with § 441(g)).

(2) *Under examination*. A change or retention of annual accounting period if the taxpayer is under examination, unless it obtains consent of the appropriate director as provided in section 6.06(1).

(3) *Before an area office*. A change or retention in annual accounting period if the taxpayer is before an area office with respect to any income tax issue and its annual accounting period is an issue under consideration by the area office.

(4) *Before a federal court*. A change or retention in annual accounting period if the taxpayer is before a federal court with respect to any income tax issue and its annual accounting period is an issue under consideration by the federal court.

(5) *Consolidated group member*. A change or retention in annual accounting period by a taxpayer that is (or was formerly) a member of a consolidated group that is: (a) under examination for a taxable year(s) that the taxpayer was a member of the group, unless the taxpayer obtains consent of the appropriate director as provided in section 6.06(1); or (b) before an area office or before a federal court for a taxable year(s) that the taxpayer was a member of the group and the annual accounting period is an issue under consideration by the area office or the federal court.

(6) *Partnerships and S corporations.* A change or retention in annual accounting period by a partnership or S corporation if, on the date the entity would otherwise file its application with the service center, the entity's annual accounting period is an issue under consideration in the examination of a partner's or shareholder's federal income tax return or an issue under consideration by an area office or by a federal court with respect to a partner's or shareholder's federal income tax return.

SECTION 4. DEFINITIONS

.01 *Taxpayer*. The term "taxpayer" has the same meaning as the term "person" as defined in § 7701(a)(1) (an individual, trust, estate, partnership, association, or corporation) rather than the meaning of the term "taxpayer" as defined in § 7701(a)(14) (any person subject to tax).

.02 *Pass-through entity.* For purposes of this revenue procedure, the term "pass-through entity" means a partnership, S corporation (as defined in § 1361), electing S corporation (*i.e.*, a corporation attempting to make an S election for the first effective year), trust, estate, common trust fund (as defined in § 584), controlled foreign corporation (as defined in § 957), foreign personal holding company (as defined in § 552), passive foreign investment company that is a qualified electing fund (as defined in § 1295), or any other similar entity.

.03 *First effective year*. The first effective year is the first taxable year for which an adoption, change, or retention in annual accounting period is effective. Thus,

in the case of a change, the first effective year is the short period required to effect the change. The first effective year is also the first taxable year for complying with all the terms and conditions set forth in the letter ruling granting permission to effect the adoption, change, or retention of the taxpayer's annual accounting period.

.04 *Short period.* In the case of a change in annual accounting period, a taxpayer's short period is the period beginning with the day following the close of the old taxable year and ending with the day preceding the first day of the new taxable year.

.05 *Field Office, Area Office, Director.* The terms "field office," "area office," and "director" have the same meaning as those terms have in Rev. Proc. 2001–1, 2001–1 I.R.B. 1 (or any successor).

.06 *Under examination.*

(1) *In general.*

(a) Except as provided in section 4.06(2) of this revenue procedure, an examination of a taxpayer with respect to a federal income tax return begins on the date the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return. An examination ends:

(i) in a case in which the Service accepts the return as filed, on the date of the "no change" letter sent to the taxpayer;

(ii) in a fully agreed case, on the earliest of the date the taxpayer executes a waiver of restrictions on assessment or acceptance of overassessment (for example, a Form 870, 4549, or 4605), the date the taxpayer makes a payment of tax that equals or exceeds the proposed deficiency, or the date of the "closing" letter (for example, Letter 891 or 987) sent to the taxpayer; or

(iii) in an unagreed or a partially agreed case, on the earliest of the date the taxpayer (or its representative) is notified by an appeals officer that the case has been referred to an area office from a field office, the date the taxpayer files a petition in the Tax Court, the date on which the period for filing a petition with the Tax Court expires, or the date of the notice of claim disallowance.

(b) An examination does not end as a result of the early referral of an issue to an area office under the provisions of Rev. Proc. 96–9, 1996–1 C.B. 575.

(c) An examination resumes on the date the taxpayer (or its representative) is notified by an appeals officer (or otherwise) that the case has been referred to a field office for reconsideration.

(2) *Partnerships and S corporations subject to TEFRA.* For a partnership or an S corporation that is subject to the TEFRA unified audit and litigation provisions (note that an S corporation is not subject to the TEFRA unified audit and litigation provisions for taxable years beginning after December 31, 1996. *See* Small Business Job Protection Act of 1996, Pub. L. No. 104–188, § 1317(a), 110 Stat. 1755, 1787 (1996)), an examination begins on the date of the notice of the beginning of an administrative proceeding sent to the Tax Matters Partner/Tax Matters Person (TMP). An examination ends:

(a) in the case in which the Service accepts the partnership or S corporation return as filed, on the date of the "no adjustments" letter or the "no change" notice of the final administrative adjustment sent to the TMP;

(b) in a fully agreed case, when all the partners or shareholders execute a Form 870–P, 870–L, or 870–S; or

(c) in an unagreed or a partially agreed case, on the earliest of the date the TMP (or its representative) is notified by an appeals officer that the case has been referred to an area office from a field office, the date the TMP (or a partner or shareholder) requests judicial review, or the date on which the period for requesting judicial review expires.

.07 *Issue under consideration.*

(1) *During an examination.* A taxpayer's annual accounting period is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR), or notification of proposed adjustments or income tax examination changes) from the examining officer(s) specifically citing the taxpayer's annual accounting period as an issue under consideration. For example, a taxpayer's annual accounting period is an issue under consideration as a result of an examination plan that identifies the propriety of the taxpayer's annual accounting period as a matter to be examined. The question of whether the taxpayer's annual accounting period is an issue under consideration may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 2001–2, 2001–1 I.R.B. 79 (or any successor), or, for exempt organizations, Rev. Proc. 2001–5, 2001–1 I.R.B. 164 (or any successor).

(2) *Before an area office.* A taxpayer's annual accounting period is an issue under consideration for the taxable years before an area office if the taxpayer's annual accounting period is included as an item of adjustment in the examination report referred to an area office or is specifically identified in writing to the taxpayer by an area office.

(3) *Before a federal court.* A taxpayer's annual accounting period is an issue under consideration for the taxable years before a federal court if the taxpayer's annual accounting period is an item included in the statutory notice of deficiency, the notice of claim disallowance, the notice of final administrative adjustment, the pleadings (for example, the petition, complaint, or answer) or amendments thereto, or is specifically identified in writing to the taxpayer by the government counsel.

SECTION 5. BUSINESS PURPOSE AND TERMS, CONDITIONS, AND ADJUSTMENTS

.01 *In General.*

(1) *Approval of requests.* Except as provided in section 5.01(2) of this revenue procedure, a request to adopt, change, or retain an annual accounting period ordinarily will be approved if the taxpayer:

(a) establishes a business purpose (within the meaning of section 5.02 of this revenue procedure) for the requested annual accounting period; and

(b) agrees to the Commissioner's prescribed terms, conditions, and adjustments (as described in sections 5.04 and 5.05 of this revenue procedure) under which the adoption, change, or retention will be effected.

(2) *Exceptions.* Notwithstanding the general rule of section 5.01(1)(a) of this revenue procedure, a taxpayer with a required taxable year (other than a partnership, S corporation, electing S corporation, or PSC) will not be granted approval under this revenue procedure to adopt, change to,

or retain a taxable year other than its required taxable year or, in appropriate circumstances, a 52–53-week taxable year that ends with reference to its required taxable year. In addition, a partnership, S corporation, electing S corporation, or PSC will be granted approval to adopt, change to, or retain an annual accounting period only if they establish a business purpose under section 5.02(1) for that annual accounting period. Notwithstanding the general rule of section 5.01(1)(b) of this revenue procedure, the Service may determine that, based on the unique facts of a particular case and in the interest of sound tax administration, terms, conditions, and adjustments that differ from those provided in this revenue procedure are more appropriate for an adoption, change, or retention made under this revenue procedure.

.02 *Business Purpose*.

(1) *Taxpayers that establish a business purpose*. Taxpayers that establish a business purpose for the requested annual accounting period under this section 5.02(1) ordinarily will be granted approval to adopt, change to, or retain that annual accounting period under this revenue procedure subject only to the general terms and conditions described in section 5.04 of this revenue procedure.

(a) *Natural business year*. A taxpayer (including a partnership, S corporation, electing S corporation, or PSC) requesting to adopt, change to, or retain an annual accounting period that is the taxpayer's natural business year (as described in section 5.03 of this revenue procedure) has established a business purpose to the satisfaction of the Commissioner.

(b) *Facts and circumstances*. A taxpayer (including a partnership, S corporation, electing S corporation, or PSC) may establish a business purpose for the requested taxable year based on all the relevant facts and circumstances. For this purpose, deferral of income to owners will not be treated as a business purpose. In addition, administrative and convenience business reasons such as those described in Rev. Rul. 87–57, 1987–2 C.B. 117, and the following will not be sufficient to establish a business purpose under this section:

(i) the use of a particular year for regulatory or financial accounting purposes;

(ii) the hiring patterns of a particular business, *e.g.*, the fact that a firm typically hires staff during certain times of the year;

(iii) the use of a particular year for administrative purposes, such as the admission or retirement of partners or shareholders, promotion of staff, and compensation or retirement arrangements with staff, partners, or shareholders;

(iv) the fact that a particular business involves the use of price lists, model years, or other items that change on an annual basis;

(v) the use of a particular year by related entities; and

(vi) the use of a particular year by competitors.

(2) *Taxpayers that are deemed to have established a business purpose.* A taxpayer other than a partnership, S corporation, electing S corporation, or PSC that does not establish a business purpose for the requested annual accounting period under section 5.02(1) of this revenue procedure generally will be deemed to have established a business purpose if it provides a non-tax reason for the requested annual accounting period and agrees to the additional terms, conditions, and adjustments described in section 5.05 of this revenue procedure, which are intended to neutralize the tax effects of any resulting substantial distortion of income. For this purpose, non-tax reasons for the requested annual accounting period may include administrative and convenience business reasons such as those described in section 5.02(1)(b) that Congress intended, and the Service has held, to be insufficient to satisfy the business purpose requirement for a partnership, S corporation, electing S corporation, or PSC to adopt, change to, or retain a taxable year other than its required taxable year. The Service anticipates that an individual taxpayer that is not a sole proprietor will be able to establish a non-tax reason for a fiscal year only in rare and unusual circumstances.

.03 *Natural business year.* A natural business year is the annual accounting period encompassing all related income and expenses. The natural business year of a taxpayer may be determined under any of the following tests (taking into account the principles of Rev. Rul. 87–57):

(1) *Annual business cycle test.* If the taxpayers's gross receipts from sales and services for the short period and the three immediately preceding taxable years indicate that the taxpayer has a peak and a non-peak period of business, the taxpayer's natural business year is deemed to end at, or soon after, the close of the peak period of business. A business whose income is steady from month to month throughout the year generally will not satisfy this test.

(2) *Seasonal business test*. If a taxpayer's business is operational for only part of the year (*e.g.*, due to weather conditions) and, as a result, the taxpayer has insignificant gross receipts during the period the business is not operational, the taxpayer's natural business year is deemed to end at, or soon after, the operations end for the season.

(3) *25-percent gross receipts test*. A natural business year may be established by any taxpayer other than a member of a tiered structure (as defined in § 444 and § 1.444–2T) using the 25-percent gross receipts test. The 25-percent gross receipts test is determined as follows:

(a) *Prior three years' gross receipts*.

(i) Gross receipts from sales and services for the most recent 12-month period that ends with the last month of the requested annual accounting period are totaled and then divided into the amount of gross receipts from sales and services for the last two months of this 12-month period.

(ii) The same computation as in (a)(i) above is made for the two preceding 12-month periods ending with the last month of the requested annual accounting period.

(b) *Natural business year*.

(i) If each of the three results described in (a)(i) and (ii) equals or exceeds 25 percent, then the requested annual accounting period is the taxpayer's natural business year.

(ii) Notwithstanding (b)(i), if the taxpayer qualifies under (b)(i) for more than one natural business year, the annual accounting period producing the highest average of the three percentages (rounded to 1/100 of a percent) described in (a)(i) and (ii) is the taxpayer's natural business year.

(c) *Special rules*.

(i) To apply the 25-percent gross receipts test for any particular tax-

able year, the taxpayer must compute its gross receipts under the method of accounting used to prepare its federal income tax returns for such taxable year.

(ii) Regardless of the taxpayer's method of accounting, the taxpayer's allocable share of income from a pass-through entity generally must be reported as gross receipts in the month that the pass-through entity's taxable year ends.

(iii) If a taxpayer has a predecessor organization and is continuing the same business as its predecessor, the taxpayer must use the gross receipts of its predecessor for purposes of computing the 25-percent gross receipts test.

(iv) If the taxpayer (including any predecessor organization) does not have a 47-month period of gross receipts (36-month period for requested taxable year plus additional 11-month period for comparing requested taxable year with other potential taxable years), then it cannot establish a natural business year using the 25-percent gross receipts test.

(v) If the requested taxable year is a 52–53-week taxable year, the calendar month ending nearest to the last day of the 52–53-week taxable year is treated as the last month of the requested taxable year for purposes of computing the 25-percent gross receipts test.

.04 *General terms and conditions.* The following general terms and conditions apply to all taxpayers that obtain approval under this revenue procedure to adopt, change, or retain an annual accounting period:

(1) *Short period tax return.* The taxpayer must file a federal income tax return for the short period required to effect a change in annual accounting period by the due date of that return, including extensions pursuant to § 1.443–1(a). However, for changes to (or from) a 52–53-week taxable year referencing the same month as the current (or requested) taxable year, see special rules in § 1.441–2. The taxpayer's taxable income for the short period must be annualized and the tax must be computed in accordance with the provisions of §§ 443(b) and 1.443–1(b). *But see* § 1.706–1(b)(4)(i) for an exception from this annualization requirement for a partnership.

(2) *Subsequent year tax returns.* Returns for subsequent taxable years generally must be made on the basis of a full 12 months (or on a 52–53-week basis) ending on the last day of the requested taxable year, unless the taxpayer secures the approval of the Commissioner to change its requested taxable year.

(3) *Book conformity.* The books of the taxpayer must be closed as of the last day of the requested taxable year. The taxpayer must compute its income and keep its books (including financial statements and reports to creditors) on the basis of the requested taxable year.

(4) *Changes in natural business year.* If a partnership, S corporation, electing S corporation, or PSC changes to or retains a natural business year under this revenue procedure and that annual accounting period no longer qualifies as a permitted taxable year, the taxpayer is using an impermissible annual accounting period and should change to a permitted taxable year. For this purpose, the term "permitted taxable year" means the required taxable year, a natural business year, the ownership taxable year, a taxable year elected under § 444, or any other taxable year for which the taxpayer establishes a business purpose to the satisfaction of the Commissioner. Certain partnerships, S corporations, electing S corporations, and PSCs may qualify for automatic approval to change their annual accounting period under Rev. Proc. 2001–XX. Other taxpayers must request approval under Rev. Proc. 2001–XX.

(5) *52–53-week taxable years.* If applicable, the taxpayer must comply with § 1.441–2(e) (relating to the timing of taking items into account in those cases where the taxable year of a pass-through entity or PSC ends with reference to the same calendar month as one or more of its partners, shareholders, or employee-owners).

(6) *Creation of net operating loss or capital loss.* If the taxpayer has a net operating loss (NOL) or capital loss (CL) in the short period required to effect a change in annual accounting period, the taxpayer may not carry the NOL or CL back, but must carry it over in accordance with the provisions of §§ 172 and 1212, respectively, beginning with the first taxable year after the short period. However, the short period NOL or CL is carried back or carried over in accordance with §§ 172 or 1212, respectively, if it is either: (a) $50,000 or less, or (b) results from a short period of 9 months or longer and is less than the NOL or CL for a full 12-month period beginning with the first day of the short period.

(7) *Creation of general business credits.* If there is an unused general business credit or any other unused credit generated in the short period, the taxpayer must carry that unused credit forward. An unused credit from the short period may not be carried back.

.05 *Additional Terms, Conditions, and Adjustments.* The additional terms, conditions, and adjustments described in this section 5.05 apply to taxpayers that obtain approval under this revenue procedure to change an annual accounting period and that establish a business purpose under section 5.02(2) of this revenue procedure. These additional terms, conditions, and adjustments are necessary to neutralize the tax effects of a substantial distortion of income that otherwise would result from the change, including: a deferral of a substantial portion of the taxpayer's income, or shifting of a substantial portion of deductions, from one taxable year to another; a similar deferral or shifting in the case of any other person, such as a beneficiary in an estate; the creation of a short period in which there is a substantial NOL, CL, or credit (including a general business credit), or the creation of a short period in which there is a substantial amount of income to offset an expiring NOL, CL, or credit.

(1) *Substantial distortion.* Distortion of income will not be considered substantial and no adjustments under this section 5.05 will be required for such distortion if the amount of the distortion is less than both:

(i) five percent of the taxpayer's estimated gross receipts for its current taxable year (computed as if the taxpayer remained on its existing taxable year); and

(ii) $500,000.

(2) *Deferral of substantial pass-through income.*

(a) *In general.* An adjustment will be required under this section 5.05(2) if the change creates a substantial distortion of income as a result of increasing the deferral of the taxpayer's distributive share of income from a pass-through entity between the taxable year of the pass-through entity and the taxpayer's taxable year. For this purpose, if the pass-through entity's taxable year is determined based

on the taxable year of its owners, the taxpayer must compare the existing deferral period (*i.e.*, between the pass-through entity's and the taxpayer's current taxable years) with the proposed deferral period (*i.e.*, between the taxable year of the pass-through entity that would be required after the requested change and the taxpayer's requested taxable year) to determine whether the deferral period is increased. If the taxpayer indirectly owns an interest in a pass-through entity through one or more other pass-through entities, the existing and proposed deferral periods generally must be determined by comparing the taxable year of the directly-owned pass-through entity with the taxpayer's taxable year. However, if the proposed change does not increase the deferral period between the taxable year of the directly-owned pass-through entity and the taxpayer's taxable year, the existing and proposed deferral periods must be determined by comparing the taxable year of the next lower-tier indirectly-owned pass-through entity with the taxpayer's taxable year until either: (1) an increase in the deferral period is found, or (2) the next lower-tier entity either does not exist or is not a pass-through entity.

(b) *Computing deferral.* The amount of deferral that results from the change is the taxpayer's allocable share of income from each pass-through entity described in (a), including ordinary income or loss, rents, royalties, interest, dividends, and the deduction equivalent of credits that accrue during the taxpayer's first effective year and, in the case of a partnership, guaranteed payments to the taxpayer that are both deductible by the partnership under its method of accounting during the partnership's first taxable year ending after the taxpayer's first effective year and attributable (on a ratable basis) to the taxpayer's first effective year. A taxpayer may aggregate the deferral of income from each pass-through entity described in (a). However, if the aggregate deferral of income from all pass-through entities described in (a) is negative (*i.e.*, an aggregate loss), there is no deferral of income. For this purpose, the taxpayer may use reasonable estimates to determine the income that accrues during the first effective year. The Service may, on examination, use any available data, including information on previous years' Schedules K-1, to verify the reasonableness of the taxpayer's estimates.

(c) *Adjustment.* If the deferral of income computed in section 5.05(2)(b) represents a substantial distortion of income (as defined in section 5.05(1)), the taxpayer must include the entire amount of the distortion (and not merely the excess over the amounts specified in section 5.05(1)) as ordinary income for the first effective year. The taxpayer also must report its allocable share of income from the pass-through entity in the taxable year following the first effective year in accordance with general tax principles (*e.g.*, § 706). The taxpayer must establish a suspense account for the amount included in ordinary income for the first effective year and deduct this amount ratably over the four taxable years immediately succeeding the first effective year. Notwithstanding the preceding sentence, if all or a portion of the suspense account is attributable to an interest in a pass-through entity that is subsequently disposed of, any amount so attributable that remains in the suspense account in the year of the disposition may be deducted in that year. In all cases, the deduction under this paragraph will be treated as an ordinary deduction. The adjustments described in this section do not affect the taxpayer's basis in the pass-through entity (such as basis in a partnership determined under § 705). *See* Examples 1, 2, and 3, section 5.06 of this revenue procedure.

(3) *Special rule for certain pass-through entities.* An adjustment similar to that described in this paragraph 5.05(2) will be required in the case of a deferral of income or shifting of deductions to another taxpayer, such as a beneficiary of an estate.

(4) *Use of expiring NOLs, CLs, and credits.* An adjustment will be required under this section 5.05(4) if the change creates a substantial distortion of income as a result of the creation of income in the short period to offset expiring NOLs, CLs, or credits (including general business credits). The amount of distortion that results from a change is the amount by which any NOL, CL, and credit that is carried over to the first effective year and that expires in that year exceeds the NOL, CL, and credit that could have been used to offset income in the taxpayer's current taxable year (computed as if the taxpayer remained on its existing taxable year). If this distortion is substantial (as defined in section 5.05(1)), any NOL, CL, or credit carried over to the first effective year will be allowed to offset income in the first effective year only to the extent that such NOL, CL, or credit could have been used to offset income in the taxpayer's current taxable year. *See* Example 4, section 5.06 of this revenue procedure.

(5) *Concurrent change for related entities.* In appropriate cases, if a taxpayer owns a majority interest in a pass-through entity, the entity will be required to concurrently change its annual accounting period as a term and condition of the approval of the taxpayer's request to change its annual accounting period, notwithstanding the testing date provisions in § 706(b)(4)(A)(ii), § 898 (c)(1)(C)(ii), § 1.921–1T(b)(6), and the special provision in § 706(b)(4)(B). If this condition applies, the pass-through entity must comply with the appropriate procedures to obtain approval for the change. *See, e.g.*, Rev. Proc. 2001–XX and § 1.898–4(b) of the proposed regulations.

(6) *Other terms, conditions, and adjustments.* In addition to the terms, conditions, and adjustments described in this section 5.05, the Service may impose any other term, condition, or adjustment that it deems appropriate under the circumstances.

.06 *Examples.* The following examples illustrate the additional terms, conditions, and adjustments that may be required under section 5.05 of this revenue procedure to obtain the Commissioner's approval for a change of an annual accounting period. In all the examples, the taxpayer is within the scope of this revenue procedure, the taxpayer has established a business purpose under section 5.02(2) of this revenue procedure, and a substantial distortion of income will result from a change to the requested taxable year.

Example 1. P, a foreign corporation, maintains its books and files its foreign country tax returns on the basis of a taxable year ending on March 31. In 2001, P acquires all the stock of S, a domestic corporation, that maintains its books and files its tax returns on the calendar year. S has a minority interest in a partnership that uses the calendar year. In order to facilitate the filing of consolidated financial statements for P and S, S applies for approval to change its taxable year to a taxable year ending on March 31 beginning on March 31, 2002. The change will cre-

ate a substantial distortion of income as a result of increasing the deferral of S's distributive share of income from its partnership interest. Consequently, S will be required, under section 5.05(2) of this revenue procedure, to report the partnership income that accrues between January 1 and March 31, 2002, as an ordinary income adjustment on its short period tax return as a term, condition, and adjustment of the change. Thereafter, on subsequent tax returns filed for its taxable year ending on March 31 (beginning March 31, 2003), S must report the partnership income for the partnership's taxable year ending December 31 based on the Schedule K-1 in accordance with § 706. To take into account S's double inclusion of the three months of partnership income from January 1 to March 31, 2002, S must recognize an ordinary deduction adjustment in each of the four taxable years following the first effective year equal to one-fourth of the ordinary income adjustment amount included on S's short period tax return. Neither adjustment will affect S's basis in the partnership.

Example 2. D is a domestic corporation that currently maintains its books and files its tax returns on the calendar year, but applies in 2002 for approval to change its taxable year to a year ending on March 31. D owns a majority interest in a partnership, PS1, which in turn owns a minority interest in another partnership, PS2. PS1 and PS2 have taxable years ending on December 31 and June 30, respectively, as required by the majority interest rule of § 706(b)(1)(b)(i). If D changes its annual accounting period to March 31, and the first effective year ends on March 31, 2002, PS1 will be required to conform its taxable year with D using a first effective year of March 31, 2002, as required under section 5.05(5) of this revenue procedure. Accordingly, D's requested change in its taxable year would not increase the deferral of D's distributive share of income or gain from PS1. However, PS2 will retain its June 30 taxable year; thus, D's requested change will increase the deferral of D's distributive share of income and gain from PS2, which is passed through to D from PS1. Assuming the deferral results in a substantial distortion of income, D will be required, under section 5.05(2) of this revenue procedure, to report its distributive share of PS2's income and gain accruing between January 1, 2002, and March 31, 2002, as an ordinary income adjustment on its tax return for the short period ending March 31 as a term and condition of the change in D's taxable year.

Example 3. The facts are the same as in Example 2, except that PS2 owns a minority interest in partnership PS3, which has a December 31 taxable year. Because D will be required as a term and condition of the change in D's taxable year to report its distributive share of PS2's income and gain accruing between January 1, 2002, and March 31, 2002, and because that distributive share will include a portion of PS2's distributive share of income from PS3, D does not need to make any additional ordinary income adjustment to take account of any increased deferral from PS3.

Example 4. Y, a domestic corporation that files its tax returns on the calendar year, applies in 2002 for consent to change its taxable year to a year ending on March 31. Y has a general business credit carryover of $100x that will expire in the current taxable year. Y reasonably expects to incur on April 30, 2002, a substantial amount that is deductible for federal income tax purposes. If Y changes its annual accounting period to March 31, and the first effective year ends on March 31, 2002, Y reasonably expects it would be able to use $90x of the $100x credit. However, if Y continues to use the calendar year for 2002, Y reasonably estimates that it would be able to use only $25x of the expiring credit. Under section 5.05(4) of this revenue procedure, Y will be allowed to use only $25x of the credit to offset income in the first effective year as a term, condition, and adjustment of the change.

SECTION 6. GENERAL APPLICATION PROCEDURES

.01 *What to file.*

(1) *Application.* To request the Commissioner's approval to adopt, change, or retain an annual accounting period under this revenue procedure, a taxpayer (other than an electing S corporation) must complete, sign, and file a current Form 1128, *Application to Adopt, Change, or Retain a Tax Year.* An electing S corporation requesting to adopt, change, or retain an annual accounting period must complete the appropriate section of, and sign and file, a current Form 2553, *Election by a Small Business Corporation.*

(2) *Signature requirement.* The application must be signed by, or on behalf of, the taxpayer requesting the adoption, change, or retention of annual accounting period by an individual with authority to bind the taxpayer in such matters. For example, an officer must sign on behalf of a corporation, a general partner on behalf of a state law partnership, a member-manager on behalf of a limited liability company, a trustee on behalf of a trust, or an individual taxpayer on behalf of a sole proprietorship. If the taxpayer is a member of a consolidated group, a Form 1128 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. If an agent is authorized to represent the taxpayer before the Service, receive the original or a copy of the correspondence concerning the request, or perform any other act(s) regarding the application filed on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the application. A taxpayer's representative without a power of attorney to represent the taxpayer as indicated in this section will not be given any information regarding the application.

(3) *Additional information regarding prior applications.*

(a) *Accounting period changed.* If a taxpayer changed its annual accounting period at any time within the most recent 48-month period ending with the last month of the requested taxable year (under either an automatic change procedure or a procedure requiring prior approval), a copy of the application for the previous change, the ruling letter, and any other related correspondence from the Service, must be attached to the application filed for the requested taxable year.

(b) *Accounting period not changed.* If a prior application (filed under either an automatic change procedure or a procedure requiring prior approval) was withdrawn, not perfected, or denied, or if the change in annual accounting period was not made, and the taxpayer files another application to change its annual accounting period within the most recent 48-month period ending with the last month of the requested taxable year, a copy of the earlier application, together with any related correspondence from the Service, must be attached to the application filed for the requested taxable year. An explanation must be furnished stating why the earlier application was withdrawn or not perfected, or why the change in annual accounting period was not made. The Service will consider the explanation in determining whether the subsequent request for a change in the taxpayer's annual accounting period will be granted.

(4) *Additional information for section 5.03 (1) and (2).* If the taxpayer requests to establish a natural business year under section 5.03(1) or (2) of this revenue procedure, it must provide its gross receipts from sales or services and approximate inventory costs (where applicable) for each month in the requested short period and for each month of the three immediately preceding taxable years.

(5) *Additional information for section 5.04.* The taxpayer must indicate whether it has an NOL or CL in the short period required to effect the change and provide the type and amount of any credits generated in the short period.

(6) *Additional information for section 5.05.* If a taxpayer requests to change an annual accounting period and establishes a business purpose under section 5.02(2) of this revenue procedure, the taxpayer must provide the following additional information necessary to determine whether a substantial distortion of income

(within the meaning of section 5.05(1)) exists and, thus, whether the additional terms, conditions, and adjustments of section 5.05 apply:

(a) If the taxpayer has an interest in a pass-through entity:

(i) Reasonable estimates of the taxpayer's gross receipts for its current taxable year (computed as if the taxpayer remained on its existing taxable year);

(ii) a comparison of the existing deferral period of any pass-through entity in which the taxpayer has a direct or, as appropriate, indirect interest (*i.e.*, the period between the pass-through entity's and the taxpayer's current taxable years) with the proposed deferral period for such pass-through entity (*i.e.,* the period between the taxable year of the pass-through entity that would be required after the requested change and the taxpayer's requested taxable year); and

(iii) Reasonable estimates of the aggregate deferral of income from all pass-through entities described in section 5.05(1);

(b) the amount of any NOL, CL, or credit carried over to the first effective year and the taxable year in which such NOL, CL, or credit was generated; and

(c) identification of any partnership, specified foreign corporation (as defined in § 898), foreign sales corporation (as defined in former § 922), or domestic international sales corporation (as defined in § 992) in which the taxpayer has a majority interest.

.02 *When to file.*

(1) *In general*. Except as provided in section 6.02(2) of this revenue procedure, a taxpayer must file a Form 1128 no earlier than the day following the end of the first effective year and no later than the 15th day of the third calendar month following the end of the first effective year. However, the Service recommends that the Form 1128 be filed as early as possible to provide the Service adequate time to respond to the request prior to the due date of the taxpayer's return for the first effective year. A taxpayer that fails to file a Form 1128 within the time period prescribed in this section 6.02(1) may request an extension of time to file under § 301.9100 of the Procedure and Administration Regulations. Under § 301.9100–3, a Form 1128 filed within 90 days after the time period prescribed in this section 6.02(1) may be considered as timely filed if the taxpayer establishes that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. If a Form 1128 is filed more than 90 days after this period, prejudice to the interests of the government will be presumed and such requests will be approved only in unusual and compelling circumstances. *See* § 301.9100–3(c)(3).

(2) *Electing S corporations*. An electing S corporation must file the Form 2553 when the election to be an S corporation is filed pursuant to § 1362(b) and § 1.1362–6. Generally, such election must be filed at any time during (a) the taxable year that immediately precedes the taxable year for which the election is to be effective, or (b) the taxable year for which the election is to be effective, provided the election is made before the 16th day of the third month of the taxable year.

.03 *Where to file.*

(1) *In general*. A taxpayer, other than an electing S corporation or exempt organization, applying for an adoption, change, or retention in annual accounting period pursuant to this revenue procedure must file its Form 1128, together with the appropriate user fee, with the Service at the following address: Internal Revenue Service, Associate Chief Counsel (Income Tax & Accounting), Attention: CC:PA:T:CRU, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044 (or, in the case of a designated private delivery service: Internal Revenue Service, Associate Chief Counsel (Income Tax & Accounting), Attention: CC:PA:T:CRU, Room 6561, 1111 Constitution Avenue, N.W., Washington, DC 20224).

(2) *Electing S corporations*. An electing S corporation requesting to adopt, change, or retain an annual accounting period pursuant to this revenue procedure must file its Form 2553 with the appropriate service center designated in the instructions to the Form 2553. The taxpayer should not include the user fee with the Form 2553 mailed to the service center. The service center will send the Form 2553 to the national office of the Service, which will then notify the taxpayer that the fee is due.

(3) *Exempt organizations*. An exempt organization applying for a change in annual accounting period pursuant to this revenue procedure must file its Form 1128, together with the appropriate user fee, with the Service at the following address: Internal Revenue Service, Commissioner, TE/GE, Attention: T:EO:RA, P.O. Box 27720, McPherson Station, Washington, DC 20038.

.04 *User fee*. Taxpayers are required to pay user fees for requests to adopt, change, or retain an annual accounting period under this revenue procedure. Rev. Proc. 2001–1, 2001–1 I.R.B. 1 and, for tax-exempt organizations, Rev. Proc. 2001–8, 2001–1 I.R.B. 239 (or any successors) contain the schedule of user fees and provide guidance for complying with the user fee requirements.

.05 *Consolidated groups – Separate Forms 1128 not required*. The common parent of a consolidated group files a Form 1128 on behalf of the consolidated group and pays only a single user fee. The common parent must indicate that the Form 1128 is for the common parent and all its subsidiaries and answer all relevant questions on the application for each member of the consolidated group. If one or more of the members of the group is requesting to use a 52–53-week taxable year that ends within the same 7-day period of the other members requested taxable year, the parent must attach a statement to its tax return for the first effective year as required by Rev. Proc. 89–56, 1989–2 C.B. 643 (or any successor). The consolidated group must also comply with all of the provisions of Rev. Rul. 72–184, 1972–1 C.B. 289 (or any successor). *See* § 1.1502–76(a)(1).

.06 *Additional procedures if under examination, before an area office, or before a federal court.*

(1) *Taxpayers under examination.*

(a) A taxpayer under examination may apply for approval to change or retain its annual accounting period under this revenue procedure only if the appropriate director consents to the change or retention. The director will consent to the change or retention unless, in the opinion of the director, the taxpayer's annual accounting period would ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the director will consent to a change where the taxpayer is using a clearly permissible annual accounting period. The di-

rector also will consent to a change from an impermissible annual accounting period where the period became impermissible (*e.g.*, due to a change in ownership or a change in the taxpayer's business) subsequent to the years under examination. The question of whether the taxpayer's annual accounting period from which the taxpayer is changing is permissible or became impermissible subsequent to the years under examination may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 2001–2, or, for tax-exempt organizations, Rev. Proc. 2001–5.

(b) A taxpayer changing or retaining an annual accounting period under this revenue procedure with the consent of the appropriate director must attach to the application a statement from the director consenting to the change or retention. The taxpayer must provide a copy of the application to the director at the same time it files the application with the national office. The application must contain the name(s) and telephone number(s) of the examining officer(s).

(2) *Taxpayer before an area office*. A taxpayer that is before an area office must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the taxpayer's annual accounting period is not an issue under consideration by the area office. The taxpayer must provide a copy of the application to the appeals officer at the same time it files the application with the national office. The application must contain the name and telephone number of the appeals officer.

(3) Taxpayer before a federal court. A taxpayer that is before a federal court must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the taxpayer's annual accounting period is not an issue under consideration by the federal court. The taxpayer must provide a copy of the application to the government counsel at the same time it files the application with the national office. The application must contain the name and telephone number of the government counsel.

SECTION 7. PROCESSING OF APPLICATION

.01 *Service discretion*. Notwithstanding any other provision of this revenue procedure, the Service reserves the right to decline to process any application filed under this revenue procedure in situations in which it would not be in the best interest of sound tax administration to permit the requested adoption, change, or retention. In this regard, the Service will consider whether the adoption, change, or retention in annual accounting period would clearly and directly frustrate compliance efforts of the Service in administering the income tax laws.

.02 *Applicability of Rev. Proc. 2001–1, Rev. Proc. 2001–4, and any successor revenue procedures*. Rev. Proc. 2001–1 or, for tax-exempt organizations, Rev. Proc. 2001–4, 2001–1 I.R.B. 121, (or any successors) will apply to any annual accounting period adoption, change, or retention request made under the provisions of this revenue procedure.

.03 *Incomplete application – 21 day rule*. If the Service receives an application that is not completed properly in accordance with the instructions on the Form 1128 (or Form 2553) and the provisions of this revenue procedure, or if supplemental information is needed, the Service will notify the taxpayer. The notification will specify the information that needs to be provided, and the taxpayer will be permitted 21 days from the date of the notification to furnish the necessary information. The Service reserves the right to impose shorter reply periods if subsequent requests for additional information are made. If the required information is not submitted to the Service within the reply period, the application will not be processed. A reasonable additional period to furnish information may be granted to a taxpayer. Any request for an extension of time to furnish necessary information must be made in writing and submitted within the 21-day period. If the extension request is denied, there is no right of appeal.

.04 *Conference in the national office*. The taxpayer must complete the appropriate line on the Form 1128 or attach a statement to the Form 2553, to request a conference of right if an adverse response is contemplated by the Service. If the taxpayer does not complete the appropriate line on the Form 1128, attach a statement to the Form 2553, or request a conference in a later written communication, the Service will presume that the taxpayer does not desire a conference. If requested, a conference will be arranged in the national office prior to the Service's formal reply to the taxpayer's application. For taxpayers other than exempt organizations, see section 11 of Rev. Proc. 2001–1 (or any successor). For exempt organizations, see section 12 of Rev. Proc. 2001–4, 2001–1 I.R.B. 121 (or any successor).

.05 *Letter ruling*. Unless otherwise specifically provided, the Commissioner's approval to adopt, change, or retain a taxpayer's annual accounting period will be set forth in a letter ruling from the national office that identifies the taxpayer's former annual accounting period; the annual accounting period the taxpayer is adopting, changing to, or retaining; the short period necessary to effect a change; and the terms, conditions, and adjustments under which the adoption, change, or retention is to be effected. *See* § 1.442–1(b). A copy of the letter ruling must be attached to the taxpayer's federal income tax return for the first effective year.

.06 *Effect of noncompliance*. If a taxpayer adopts, changes, or retains an annual accounting period without authorization or without complying with all of the provisions of this revenue procedure and the letter ruling granting permission for the change, the taxpayer has initiated an adoption, change, or retention in annual accounting period without obtaining the approval of the Commissioner as required by §§ 441(i), 442, 706(b), and 1378. Upon examination, a taxpayer that has initiated an unauthorized adoption, change, or retention of annual accounting period may be denied the adoption, change, or retention. For example, the taxpayer may be required to recompute its taxable income or loss in accordance with its former (or required, if applicable) taxable year.

.07 *Effect on other offices of the Service*. The provisions of this revenue procedure are not intended to preclude an appropriate representative of the Service (for example, an appeals officer with delegated settlement authority) from settling a particular taxpayer's case involving an accounting

period issue by agreeing to terms, conditions, and adjustments that differ from those that might be provided under this revenue procedure when it is in the best interest of the government to do so.

SECTION 8. EFFECT OF APPROVAL

.01 *Audit Protection*

(1) *In general*. Except as provided in section 8.01(2) of this revenue procedure, a taxpayer that files a Form 1128 in compliance with all the applicable provisions of this revenue procedure will not be required by the Service to change its annual accounting period for a taxable year prior to the first effective year.

(2) *Exceptions*. The Service may change a taxpayer's annual accounting period for a prior taxable year if:

(a) the taxpayer withdraws or does not perfect its request;

(b) the national office denies the request;

(c) the taxpayer declines to implement the change;

(d) the taxpayer implements the change but does not comply with all the applicable provisions of this revenue procedure and the letter ruling granting permission for the change; or

(e) the national office modifies or revokes the ruling because there has been a misstatement or omission of material facts.

.02 *Subsequently required changes*.

(1) *In general*. A taxpayer that adopts, changes, or retains its annual accounting period pursuant to this revenue procedure may be required thereafter to change its annual accounting period for the following reasons:

(a) the enactment of legislation;

(b) a decision of the United States Supreme Court;

(c) the issuance of temporary or final regulations;

(d) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin;

(e) the issuance of written notice to the taxpayer that the change in accounting period was granted in error or is not in accord with the current views of the Service; or

(f) a change in the material facts on which the approval was based.

(2) *Retroactive change or modification*. Except in rare or unusual circumstances, if a taxpayer that adopted, changed, or retained its annual accounting period under this revenue procedure is subsequently required under section 8.02(1) of this revenue procedure to change its annual accounting period, the required change will not be applied retroactively provided that:

(a) the taxpayer complied with all the applicable provisions of the letter ruling granting permission for the change and this revenue procedure;

(b) there has been no misstatement or omission of material facts;

(c) there has been no change in the material facts on which the approval was based;

(d) there has been no change in the applicable law; and

(e) the taxpayer to whom approval was granted acted in good faith in relying on the approval and applying the change retroactively would be to the taxpayer's detriment.

SECTION 9. REVIEW BY DIRECTOR

.01 *In general*. A director must apply a ruling obtained under this revenue procedure in determining the taxpayer's tax liability unless the director recommends that the ruling should be modified or revoked. The director will ascertain if:

(1) the representations on which the ruling was based reflect an accurate statement of the material facts;

(2) the amount of the adjustments required to effect the change, if any, were properly determined;

(3) the adoption, change, or retention in annual accounting period was implemented as proposed in accordance with the terms and conditions of the letter ruling and this revenue procedure;

(4) there has been any change in the material facts on which the ruling was based during the period that the new or retained annual accounting period was used; and

(5) there has been any change in the applicable law during the period the new or retained annual accounting period was used.

.02 *National office consideration*. If a director recommends that the ruling (other than the amount of the adjustments required to effect the change) should be modified or revoked, the director will forward the matter to the national office for consideration before any further action is taken. Such a referral to the national office will be treated as a request for technical advice, and the provisions of Rev. Proc. 2001–2 or, for tax-exempt organizations, Rev. Proc. 2001–5, will be followed.

SECTION 10. EFFECTIVE DATE

.01 *In general*. Except as provided in section 10.02 of this revenue procedure, this revenue procedure is effective for applications filed on or after [INSERT DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN].

.02 *Transition rule for pending applications*. If a taxpayer filed an application before [INSERT DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN] and the application is pending with the national office on [INSERT DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN], the taxpayer may request that the application be processed in accordance with this revenue procedure. However, the national office will process applications filed before [INSERT DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN] in accordance with prior authorities unless, prior to the later of [INSERT DATE THAT IS 45 DAYS AFTER THE DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN] or the issuance of the letter ruling granting or denying consent to the adoption, change, or retention, the taxpayer notifies the national office that it requests that its application be processed in accordance with this revenue procedure.

SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 85–16 and Rev. Proc. 74–33 are superseded.

SECTION 12. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been submitted to the Office of Management and Budget for review and approval in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control number _____.

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

The collections of information in this revenue procedure are set forth in section 6.01. The information is required to determine whether the taxpayer's requested annual accounting period will result in a distortion of income. This information will be used by the Service to determine which terms, conditions, and adjustments will be necessary to effect the adoption, change, or retention in annual accounting period. The collections of information are required to obtain the Service's approval for the adoption, change, or retention. The likely respondents are the following: individuals, farms, business or other for-profit organizations, non-profit organizations, and small businesses or organizations.

The estimated total annual reporting burden is 2,000 hours.

The estimated annual burden per respondent varies from .5 of an hour to 5 hours, depending on the individual circumstances, with an estimated average of 2 hours.

The estimated number of respondents is 1,000.

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.

DRAFTING INFORMATION

The author of this revenue procedure is Martin Scully, Jr. of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Scully at (202) 622-4960 (not a toll-free call).

Procedures for Requesting an Adoption, Change, or Retention of Accounting Period

Notice 2001–35

This notice provides a proposed revenue procedure that, when finalized, will provide the procedures under § 442 of the Internal Revenue Code, and the regulations thereunder, for certain partnerships, S corporations, electing S corporations, and personal service corporations (PSCs) to obtain automatic approval of the Commissioner to adopt, change, or retain their annual accounting periods.

This proposed revenue procedure is being issued concurrently with new proposed regulations under §§ 441, 442, 706, and 1378, and a proposed revenue procedure (Notice 2001–34, 2001–23 I.R.B. 1302) providing the procedures for any taxpayer outside the scope of the automatic approval revenue procedures to establish a business purpose and request the prior approval of the Commissioner to adopt, change, or retain an annual accounting period. References in this proposed revenue procedure to the regulations under §§ 441, 442, 706, and 1378 are to the new proposed regulations, and references to "Rev. Proc. 2001–XX" are to the proposed prior approval revenue procedure. All three documents are intended to be finalized concurrently.

The proposed revenue procedure modifies, amplifies, and supersedes Rev. Proc. 87–32, 1987–2 C.B. 396. In general, the proposed revenue procedure provides additional circumstances under which the Internal Revenue Service will grant automatic approval for an adoption, change, or retention in annual accounting period based on requests that the Service has granted under its current ruling practice. In addition, the proposed revenue procedure provides audit protection to taxpayers adopting, changing, or retaining an annual accounting period under the revenue procedure. In conjunction with the provision of audit protection, taxpayers under examination that do not obtain consent of the appropriate director are not within the scope of the proposed revenue procedure.

The Service welcomes comments on the proposed revenue procedure provided in this notice. Comments should be submitted by September 11, 2001, either to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
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Rev. Proc. 2001–XX

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DRAFTING INFORMATION

SECTION 1. PURPOSE

This revenue procedure provides procedures for certain partnerships, S corporations, electing S corporations (as defined in section 5.01), and personal service corporations (PSCs) to obtain automatic approval to adopt, change, or retain their annual accounting period under § 442 of the Internal Revenue Code. This revenue procedure modifies, amplifies, and supersedes Rev. Proc. 87–32, 1987–2 C.B. 396. Any partnership, S corporation, electing S corporation, or PSC complying with the applicable provisions of this revenue procedure has established a business purpose and obtained the approval of the Commissioner of the Internal Revenue Service to adopt, change, or retain its annual accounting period under § 442 and the Income Tax Regulations thereunder.

SECTION 2. BACKGROUND

.01 *Taxable Year Defined*.

(1) *In general*. Section 441(b) and § 1.441–1(b)(1) of the regulations provide that the term "taxable year" generally means the taxpayer's annual accounting period, if it is a calendar year or fiscal year, or, if applicable, the taxpayer's required taxable year.

(2) *Annual accounting period*. Section 441(c) and § 1.441–1(b)(3) provide that the term "annual accounting period" means the annual period (calendar year or fiscal year) on the basis of which the taxpayer regularly computes its income in keeping its books.

(3) *Required taxable year*.

(a) *In general*. Section 1.441–1(b)(2) provides that certain taxpayers must use the particular taxable year that is required under the Code and the regulations thereunder (the "required taxable year). For example, as described below, a partnership, S corporation, or PSC generally is required to conform its taxable year to the taxable year of its owners. H.R. Rep. No. 99–841 (Conf. Rep.), 99th Cong., 2d Sess., II–318 (1986), 1986–3 (Vol. 4) C.B. 319. Exceptions are provided for certain taxpayers, including a partnership, S corporation, or PSC that elects to use a 52–53-week taxable year that ends with reference to its required taxable year, makes an election under § 444, or establishes a business purpose for having a different taxable year and obtains approval under § 442.

(b) *Partnerships*. Section 706(b) and the regulations thereunder generally provide that a partnership's taxable year must be its required taxable year. However, a partnership may have a taxable year other than its required taxable year if it elects to use a 52–53-week taxable year that ends with reference to its required taxable year, makes an election under § 444, or establishes a business purpose for having a different taxable year and obtains approval under § 442. The required taxable year for a partnership is:

(i) the taxable year of one or more of its partners who have an aggregate interest in partnership profits and capital of greater than 50 percent;

(ii) if there is no taxable year described in clause (i), the taxable year of all the principal partners of the partnership (*i.e.*, all the partners having an interest of 5-percent or more in partnership profits or capital); or

(iii) if there is no taxable year described in clause (i) or (ii), the taxable year that results in the least aggregate deferral of income to the partners.

(c) *S corporations*. Section 1378 and § 1.1378–1(a) provide that the taxable year of an S corporation must be a permitted year or a taxable year elected under § 444. The term "permitted year" means (1) the required taxable year (*i.e.*, a taxable year ending on December 31), (2) a 52–53-week taxable year ending with reference to the required taxable year, or (3) any other accounting period for which the corporation establishes a business purpose to the satisfaction of the Commissioner.

(d) *PSCs*. Section 441(i)(1) and § 1.441–3 provide that the taxable year of a PSC must be the calendar year unless the PSC elects to use a 52–53-week taxable year that ends with reference to the calendar year, makes an election under § 444, or establishes, to the satisfaction of the Commissioner, a business purpose for having a different period for its taxable year.

.02 *Adoption of a Taxable Year*. A newly-formed partnership, S corporation, or PSC may adopt its required taxable

year, a 52–53-week taxable year ending with reference to its required taxable year, or a taxable year elected under § 444 without the approval of the Commissioner pursuant to § 441. If, however, a partnership, S corporation, or PSC wants to adopt any other taxable year, it must establish a business purpose and obtain approval under § 442. See §1.441–1(c).

.03 *Change in Taxable Year*.

(1) *In general*. Section 1.442–1(a)(1) generally provides that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain approval from the Commissioner.

(2) *Annualization of short period return*. Section 1.443–1(b)(1)(i) provides that if a return is made for a short period resulting from a change of an annual accounting period, the taxable income for the short period must be placed on an annual basis by multiplying the income by 12 and dividing the result by the number of months in the short period. Unless § 443(b)(2) and § 1.443–1(b)(2) apply, the tax for the short period is the same part of the tax computed on an annual basis as the number of months in the short period is of 12 months. See § 1.706–1(b)(4)(i) for an exception for partnerships.

(3) *No retroactive change in annual accounting period*. Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in annual accounting period, regardless of whether the change is to a required taxable year.

.04 *Retention of a Taxable Year*. In certain cases, a partnership, S corporation, or PSC will be required to change its taxable year unless it establishes a business purpose and obtains the approval of the Commissioner under § 442, or makes an election under § 444, to retain its current taxable year. See § 1.441–1(d). For example, a corporation on a June 30 fiscal year that either becomes a PSC or elects to be an S corporation, and as a result is required to use the calendar year, must obtain the approval of the Commissioner to retain its current fiscal year. Similarly, a partnership using a taxable year that corresponds to its required taxable year generally must obtain the approval of the Commissioner to retain that taxable year if its required taxable year changes as a result of a change in ownership. But see § 706(b)(4)(B). However, a partnership that has previously established a business purpose to the satisfaction of the Commissioner to use a June 30 fiscal year is not required to obtain the approval of the Commissioner to retain its June 30 fiscal year if its required taxable year changes from September 30 to November 30.

.05 *Approval of an adoption, change, or retention*. Section 1.442–1(b) provides that in order to secure approval to adopt, change, or retain an annual accounting period, a taxpayer must file an application generally on Form 1128, *Application to Adopt, Change, or Retain a Tax Year*, with the Commissioner no earlier than the day following the close of the first taxable year in which the taxpayer wants the adoption, change, or retention to be effective (the "first effective year") and no later than the 15th day of the third calendar month following the close of the first effective year. In general, an adoption, change, or retention in annual accounting period will be approved where the taxpayer establishes a business purpose for the requested annual accounting period and agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the adoption, change, or retention.

.06 *Business purpose*.

(1) Section 1.442–1(b) provides that generally the requirement of a business purpose will be satisfied, and adjustments to neutralize any tax consequences will not be required, if the requested annual accounting period coincides with the taxpayer's required taxable year, ownership taxable year, or natural business year. Section 1.442–1(b) also provides that, in the case of a partnership, S corporation, electing S corporation, or PSC, deferral of income to partners, shareholders, or employee-owners, will not be treated as a business purpose.

(2) A taxpayer is deemed to have established a natural business year if it satisfies the "25-percent gross receipts test." See Rev. Proc. 87–32, superseding Rev. Proc. 83–25, 1983–1 C.B. 689. The Conference Report to the Tax Reform Act of 1986 states that the Secretary may prescribe other tests in addition to the 25-percent gross receipts test to be used to establish the existence of a business purpose if, in the discretion of the Secretary, such tests are desirable and expedient towards the efficient administration of the tax laws. *See* H.R. Rep. No. 99– 841 (Conf. Rep.), 99th Cong., 2d Sess., II–318 (1986), 1986–3 (Vol. 4) C.B. 319.

.07 *Section 444 Election*s. A partnership, S corporation, electing S corporation, or PSC generally can elect under § 444 to use a taxable year other than its required taxable year if the deferral period of the new taxable year is three months or less. A partnership and an S corporation with a § 444 election must make required payments under § 7519 that approximate the amount of deferral benefit and a PSC with a § 444 election is subject to the minimum distribution requirements of § 280H. A taxpayer may automatically adopt, change to, or retain a taxable year permitted under § 444 by filing a Form 8716, *Election to Have a Tax Year Other Than a Required Tax Year*. A taxpayer that wants to terminate its § 444 election must follow the automatic procedures under § 1.444–1T(a)(5) to change to its required taxable year or establish a business purpose for its taxable year pursuant to § 442 and Rev. Proc. 2001–XX [insert cite].

.08 *Rev. Proc. 87–32*. Rev. Proc. 87–32 generally provided automatic approval provisions for a partnership, S corporation, electing S corporation, or PSC to retain or change to a natural business year and for an S corporation or electing S corporation to adopt, change to, or retain an ownership taxable year. In addition, special notification procedures were provided for a partnership, S corporation, electing S corporation, or PSC to adopt, change to, or retain a required taxable year.

SECTION 3. SIGNIFICANT CHANGES

Significant changes to Rev. Proc. 87–32 made by this revenue procedure include:

.01 Section 4.01(1) of this revenue procedure clarifies that a partnership, S corporation, electing S corporation, or PSC may change automatically to its required taxable year.

.02 Section 4.01(2) of this revenue procedure allows a partnership, S corporation, electing S corporation, or PSC to change automatically to a natural business year that satisfies the 25-percent gross receipts test, regardless of whether such year results in more deferral of income than its present taxable year.

.03 Section 4 of this revenue procedure allows a PSC to automatically change its taxable year even if the taxpayer makes an S corporation election for the taxable year immediately following the short period.

.04 Sections 4.01(1), (2), and (3) of this revenue procedure allow, in appropriate circumstances, a partnership, S corporation, electing S corporation, or PSC to adopt, change to, or retain a 52–53-week taxable year ending with reference to the required taxable year, natural business year, or ownership taxable year.

.05 Section 4.01(4) of this revenue procedure allows any partnership, S corporation, electing S corporation, or PSC to automatically change from a 52–53-week taxable year to a non-52–53-week taxable year that ends on the last day of the same calendar month, and vice versa.

.06 Section 4.02 of this revenue procedure generally prevents a partnership, S corporation, electing S corporation, or PSC from using this revenue procedure to change its annual accounting period if the taxpayer is under examination and does not obtain consent from the appropriate director, or is before an area office or before a federal court and its annual accounting period is an issue under consideration.

.07 Section 4.02(2) of this revenue procedure reduces the waiting time between changes from six to four years and provides that a change to a required or ownership taxable year, and a change to or from a 52–53-week taxable year referencing the same month, will not be considered changes within four years.

.08 Section 5.05 of this revenue procedure disregards certain tax-exempt entities for purposes of determining the ownership taxable year of an S corporation or electing S corporation.

.09 Section 7.02(2) of this revenue procedure extends the filing requirements for filing a Form 1128 to the due date of the taxpayer's federal income tax return (including extensions) for the first effective year.

.10 Section 8.01 provides audit protection for partnerships, S corporations, electing S corporations, or PSCs that change their annual accounting period under this revenue procedure.

SECTION 4. SCOPE

.01 *Applicability.* This revenue procedure, which is the exclusive procedure for taxpayers within its scope to secure the Commissioner's approval, applies to:

(1) *Required taxable year*. A partnership, S corporation, electing S corporation, or PSC that wants to change to its required taxable year (as defined in section 5.02 of this revenue procedure), or to a 52–53-week taxable year ending with reference to such taxable year;

(2) *Natural business year*. A partnership, S corporation, electing S corporation, or PSC (other than a member of a tiered structure as defined in § 444 and 1.444–2T) that wants to change to or retain a natural business year that satisfies the 25-percent gross receipts test described in section 5.04 of this revenue procedure, or to a 52–53-week taxable year ending with reference to such taxable year;

(3) *Ownership taxable year*. An S corporation or electing S corporation that wants to adopt, change to, or retain its ownership taxable year (as defined in section 5.05 of this revenue procedure), or a 52–53-week taxable year ending with reference to such taxable year; or

(4) *52–53-week taxable year*. A partnership, S corporation, electing S corporation, or PSC that wants to change from a 52–53-week taxable year to a non-52–53-week taxable year that ends on the last day of the same calendar month, and *vice versa*.

.02 *Inapplicability*. This revenue procedure does not apply to:

(1) *Under examination*. A change or retention in annual accounting period if the partnership, S corporation, electing S corporation, or PSC is under examination, unless it obtains consent of the appropriate director as provided in section 7.03(1).

(2) *Before an area office*. A change or retention in annual accounting period if the partnership, S corporation, electing S corporation, or PSC is before an area office with respect to any income tax issue and its annual accounting period is an issue under consideration by the area office;

(3) *Before a federal court*. A change or retention in annual accounting period if the partnership, S corporation, electing S corporation, or PSC is before a federal court with respect to any income tax issue and its annual accounting period is an issue under consideration by the federal court;

(4) *Partnerships and S corporations.* A change or retention in annual accounting period by a partnership or S corporation if, on the date the entity would otherwise file its application with the service center, the entity's annual accounting period is an issue under consideration in the examination of a partner or shareholder's federal income tax return or an issue under consideration by an area office or by a federal court with respect to a partner or shareholder's federal income tax return.

(5) *Prior change*. A change to, or retention of, a natural business year as described in section 4.01(2) of this revenue procedure if the partnership, S corporation, electing S corporation, or PSC has changed its annual accounting period at any time within the most recent 48-month period ending with the last month of the requested taxable year. For this purpose, the following changes are not considered changes in annual accounting period:

(a) a change to a required taxable year or ownership taxable year, as described in section 4.01(1) or (3) of this revenue procedure, respectively,

(b) a change to or from a 52–53-week taxable year as described in section 4.01(4) of this revenue procedure, or

(c) a change by a former subsidiary to its former common parent's taxable year in order to comply with the common taxable year requirement of section 1.1502–76(a)(1).

.03 *Nonautomatic Changes*. Any partnership, S corporation, electing S corporation, or PSC that wants to adopt, change to, or retain an annual accounting period not described in section 4.01 of this revenue procedure, or that cannot make a change under this revenue procedure because of a prior change as described in section 4.02(5) of this revenue procedure, must obtain the approval of the Commissioner. See § 1.442–1(b) and Rev. Proc. 2001–XX, for rules relating to nonautomatic changes of annual accounting periods by partnerships, S corporations, electing S corporations, and PSCs.

SECTION 5. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure:

.01 *Electing S Corporations.* "Electing S corporations" are corporations attempting to make an S election for the short pe-

riod described in section 6.02 of this revenue procedure. See Rev. Proc. 2000–11, 2000–3 I.R.B. 309, for procedures for automatic approval to change an annual accounting period by corporations attempting to make an S election for the taxable year immediately following the short period.

.02 *Required Taxable Year.* The "required taxable year" is the taxable year determined under § 706(b) in the case of a partnership, § 1378 in the case of an S corporation or an electing S corporation, or § 441(i) in the case of a PSC, without taking into account any taxable year that is allowable by reason of a business purpose (including a grandfathered fiscal year) or a § 444 election.

.03 *Permitted Taxable Year*. A "permitted taxable year" is the required taxable year, a natural business year, the ownership taxable year, a § 444 taxable year, or any other taxable year for which the taxpayer establishes a business purpose to the satisfaction of the Commissioner.

.04 *Natural Business Year*. A partnership, S corporation, electing S corporation, or PSC establishes a "natural business year" under this revenue procedure by satisfying the following "25-percent gross receipts test":

(1) *Prior three years gross receipts.*

(a) Gross receipts from sales and services for the most recent 12-month period that ends with the last month of the requested annual accounting period are totaled and then divided into the amount of gross receipts from sales and services for the last two months of this 12-month period.

(b) The same computation as in (1)(a) above is made for the two preceding 12-month periods ending with the last month of the requested annual accounting period.

(2) Natural business year.

(a) If each of the three results described in (1) equals or exceeds 25 percent, then the requested annual accounting period is deemed to be the taxpayer's natural business year.

(b) Notwithstanding paragraph (2)(a), if the taxpayer qualifies under (2)(a) for more than one natural business year, the taxable year producing the highest average of the three percentages (rounded to 1/100 of a percent) described in (1) is the taxpayer's natural business year.

(3) *Special rules*. (a) To apply the 25-percent gross receipts test described in (1) for any particular year, the taxpayer must compute its gross receipts under the method of accounting used to prepare its federal income tax returns for such taxable year.

(b) Regardless of the taxpayer's method of accounting, the taxpayer's allocable share of income from a pass-through entity (*e.g.*, an estate, common trust fund (as defined in § 584), controlled foreign corporation (as defined in § 957), foreign personal holding company (as defined in § 552), or passive foreign investment company that is a qualified electing fund (as defined in § 1295)), generally must be reported as gross receipts in the month that the pass-through entity's taxable year ends.

(c) If a taxpayer has a predecessor organization and is continuing the same business as its predecessor, the taxpayer must use the gross receipts of its predecessor for purposes of computing the 25-percent gross receipts test.

(d) If the taxpayer (including any predecessor organization) does not have a 47-month period of gross receipts (36-month period for requested taxable year plus additional 11-month period for comparing requested taxable year with other potential taxable years), then it cannot establish a natural business year under this revenue procedure.

(e) If the requested taxable year is a 52–53-week taxable year, the calendar month ending nearest to the last day of the 52–53-week taxable year is treated as the last month of the requested taxable year for purposes of computing the 25-percent gross receipts test.

.05 *Ownership Taxable Year*. For an S corporation or electing S corporation, an "ownership taxable year" is the taxable year (if any) that, as of the first day of the first effective year, constitutes the taxable year of one or more shareholders (including any shareholder that concurrently changes to such taxable year) holding more than 50-percent of the corporation's issued and outstanding shares of stock. A shareholder in an S corporation or electing S corporation that wants to concurrently change its taxable year must follow the instructions generally applicable to taxpayers changing their taxable years contained in § 1.442–1(b) and Rev. Proc. 2001–XX. For this purpose, under principles similar to § 1.706–3T for determining the taxable year of a partnership, a shareholder that is tax-exempt under § 501(a) is disregarded if such shareholder is not subject to tax on any income attributable to the S corporation.

.06 *Grandfathered Fiscal Year*. A grandfathered fiscal year is a fiscal year (other than a year that resulted in a three-month or less deferral of income) that a partnership or an S corporation received permission to use on or after July 1, 1974, by a letter ruling (*i.e.*, not by automatic approval).

.07 *First Effective Year*. The first effective year is the first taxable year for which an adoption, change, or retention in annual accounting period is effective. Thus, in the case of a change, the first effective year is the short period required to effect the change.

.08 *Short Period.* In the case of a change in annual accounting period, a taxpayer's short period is the period beginning with the day following the close of the old taxable year and ending with the day preceding the first day of the new taxable year.

.09 *Field Office, Area Office, Director*. The terms "field office," "area office," and "director" have the same meaning as those terms have in Rev. Proc. 2001–1, 2001–1 I.R.B 1 (or any successor).

.10 *Under Examination.*

(1) *In general*.

(a) Except as provided in section 5.10(2) of this revenue procedure, an examination of a taxpayer with respect to a federal income tax return begins on the date the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return. An examination ends:

(i) in a case in which the Service accepts the return as filed, on the date of the "no change" letter sent to the taxpayer;

(ii) in a fully agreed case, on the earliest of the date the taxpayer executes a waiver of restrictions on assessment or acceptance of overassessment (for example, Form 870, 4549, or 4605), the date the taxpayer makes a payment of tax that equals or exceeds the proposed deficiency, or the date of the "closing" letter (for example, Letter 891 or 987) sent to the taxpayer; or

(iii) in an unagreed or a partially agreed case, on the earliest of the date the taxpayer (or its representative) is notified by an appeals officer that the case has been referred to an area office from a field office, the date the taxpayer files a petition in the Tax Court, the date on which the period for filing a petition with the Tax Court expires, or the date of the notice of claim disallowance.

(b) An examination does not end as a result of the early referral of an issue to an area office under the provisions of Rev. Proc. 96–9, 1996–1 C.B. 575.

(c) An examination resumes on the date the taxpayer (or its representative) is notified by an appeals officer (or otherwise) that the case has been referred to a field office for reconsideration.

(2) *Partnerships and S corporations subject to TEFRA.* For a partnership or S corporation that is subject to the TEFRA unified audit and litigation provisions (note that an S corporation is not subject to the TEFRA unified audit and litigation provisions for taxable years beginning after December 31, 1996. See Small Business Job Protection Act of 1996, Pub. L. No. 104–188, § 1317(a), 110 Stat. 1755, 1787 (1996)), an examination begins on the date that the notice of the beginning of an administrative proceeding is sent to the Tax Matters Partner/Tax Matters Person (TMP). An examination ends:

(a) in a case in which the Service accepts the partnership or S corporation return as filed, on the date of the "no adjustments" letter or the "no change" notice of final administrative adjustment sent to the TMP;

(b) in a fully agreed case, when all the partners or shareholders execute a Form 870–P, 870–L, or 870–S; or

(c) in an unagreed or a partially agreed case, on the earliest of the date the TMP (or its representative) is notified by an appeals officer that the case has been referred to the area office from a field office, the date the TMP (or a partner or shareholder) requests judicial review, or the date on which the period for requesting judicial review expires.

.11 *Issue Under Consideration.*

(1) *During an examination.* A taxpayer's annual accounting period is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR), or notification of proposed adjustments or income tax examination changes) from the examining officer(s) specifically citing the taxpayer's annual accounting period as an issue under consideration. For example, a taxpayer's annual accounting period is an issue under consideration as a result of an examination plan that identifies the propriety of the taxpayer's annual accounting period as a matter to be examined. The question of whether the taxpayer's annual accounting period is an issue under consideration may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 2001–2, 2001–1 I.R.B. 79 (or any successor).

(2) *Before an area office.* A taxpayer's annual accounting period is an issue under consideration for the taxable years before an area office if the taxpayer's annual accounting period is included as an item of adjustment in the examination report referred to the area office or is specifically identified in writing to the taxpayer by the area office.

(3) *Before a federal court.* A taxpayer's annual accounting period is an issue under consideration for the taxable years before a federal court if the taxpayer's annual accounting period is an item included in the statutory notice of deficiency, the notice of claim disallowance, the notice of final administrative adjustment, the pleadings (for example, the petition, complaint, or answer) or amendments thereto, or is specifically identified in writing to the taxpayer by the government counsel.

SECTION 6. TERMS AND CONDITIONS

.01 *In General.* An adoption, change, or retention in annual accounting period filed under this revenue procedure must be made pursuant to the terms and conditions provided in this revenue procedure.

.02 *Short Period Tax Return.* The taxpayer generally must file a federal income tax return for the short period required to effect a change by the due date of that return, including extensions, in accordance with § 1.443–1. For a change to or from a 52–53-week taxable year that results in a short period of 359 days or more, or six days or less, the tax computation under § 443(b) does not apply. If the short period is 359 days or more, it is treated as a full taxable year. If the short period is six days or less, such short period is not a separate taxable year but is added to and deemed a part of the following taxable year. (In the case of a change to or from a 52–53-week taxable year not involving a change of the month with reference to which the taxable year ends, the tax computation under § 443(b) does not apply because the short period will always be 359 days or more, or six days or less.) In the case of a PSC with a short period that is more than six days, but less than 359 days, taxable income for the short period must be placed on an annual basis for the purpose of § 443(b) by multiplying such income by 365 and dividing the result by the number of days in the short period. In such case, the tax for the short period is the same part of the tax computed on such income placed on an annual basis as the number of days in the short period is of 365 days (unless § 443(b)(2) and paragraph (b)(2) of § 1.443–1, relating to the alternative tax computation, apply). But see § 1.706–1(b)(4)(i) for an exception from this annualization requirement for a partnership.

.03 *Subsequent Year Tax Returns.* Returns for subsequent taxable years generally must be made on the basis of a full 12 months (or on a 52–53-week taxable year) ending on the last day of the requested taxable year, unless the taxpayer secures the approval of the Commissioner to change that taxable year.

.04 *Record Keeping/Book Conformity.* The books of the taxpayer must be closed as of the last day of the requested taxable year. Except for changes described in sections 4.01(1) or 4.01(3) of this revenue procedure to the taxpayer's required taxable year or ownership taxable year, respectively, the taxpayer must compute its income and keep its books (including financial statements and reports to creditors) on the basis of the requested taxable year.

.05 *Changes in Natural Business Year.* If a partnership, S corporation, electing S corporation, or PSC changes to or retains a natural business year under this revenue procedure and that year no longer qualifies as a permitted taxable year, the taxpayer is using an impermissible annual accounting period and should change to a

permitted taxable year. Taxpayers qualifying under section 4 of this revenue procedure may request automatic approval for the change under the provisions of this revenue procedure. Other taxpayers must request approval under Rev. Proc. 2001–XX.

.06 *Changes in Ownership Taxable Year.* An S corporation or electing S corporation that adopts, changes to, or retains an ownership taxable year under this revenue procedure must change to a permitted taxable year, or request approval to retain its current taxable year, if, as of the first day of any taxable year, its ownership taxable year changes. S corporations qualifying under section 4 of this revenue procedure may request automatic approval for the change or retention under the provisions of this revenue procedure. Other taxpayers must request approval under Rev. Proc. 2001–XX.

.07 *52–53-week Taxable Years*. If applicable, the taxpayer must comply with § 1.441–2(e) (relating to the timing of taking items into account in those cases where the taxable year of a pass-through entity or PSC ends with reference to the same calendar month as one or more of its partners or shareholders or employee-owners).

.08 *Net Operating Losses (NOLs).* Solely in the case of a PSC changing to a natural business year, if the PSC has an NOL in the short period required to effect the change, the PSC may not carry the NOL back but must carry it over in accordance with the provisions of § 172 beginning with the first taxable year following the short period. However, the short period NOL is carried back or carried over in accordance with § 172 if it is either (a) $50,000 or less, or (b) results from a short period of 9 months or longer and is less than the NOL for a full 12-month period beginning with the first day of the short period.

.09 *General Business Credits*. Solely in the case of a PSC changing to a natural business year, if there is an unused general business credit or any other unused credit generated in the short period, the PSC must carry that unused credit forward. An unused credit from the short period may not be carried back.

SECTION 7. GENERAL APPLICATION PROCEDURES

.01 *Approval*. Approval is hereby granted to any partnership, S corporation, electing S corporation, or PSC within the scope of this revenue procedure to adopt, change, or retain its annual accounting period, provided the taxpayer complies with all the applicable provisions of this revenue procedure. Approval is granted beginning with the first effective year. A partnership, S corporation, electing S corporation, or PSC granted approval under this revenue procedure to adopt, change to, or retain an annual accounting period other than its required year is deemed to have established a business purpose for the adoption, change, or retention to the satisfaction of the Commissioner.

.02 *Filing Requirements***.**

(1) *Where to file*. A taxpayer within the scope of this revenue procedure that wants to adopt, change, or retain its annual accounting period under this revenue procedure must complete and file an application (*i.e.*, a current Form 1128 or Form 2553, *Election by a Small Business Corporation*, in the case of an electing S corporation) with the Director, Internal Revenue Service Center, Attention: ENTITY CONTROL, where the taxpayer files its income tax returns. No copies of Form 1128 (or Form 2553) are required to be sent to the National Office. The taxpayer also must attach a copy of the Form 1128 (or Form 2553) to the federal income tax return filed for the first effective year.

(2) *When to file*. The Form 1128 must be filed no earlier than the day following the end of the first effective year and no later than the due date (including extensions) for filing the federal income tax return for the first effective year. For electing S corporations, the Form 2553 must be filed when the election to be an S corporation is filed pursuant to § 1362(b) and § 1.1362–6. Generally, such election must be filed at any time during (a) the taxable year that immediately precedes the taxable year for which the election is to be effective, or (b) the taxable year for which the election is to be effective, provided the election is made before the 16th day of the third month of the taxable year.

(3) *Label*. In order to assist in the processing of the adoption, change, or retention in annual accounting period, taxpayers should write at the top of page 1 of the Form 1128 (Form 2553): "FILED UNDER REV. PROC. 2001–[INSERT NUMBER]".

(4) *Signature requirements*. In the case of a partnership, the Form 1128 must be signed on behalf of the partnership by a general partner. In the case of an Limited Liability Company (LLC) that elects to be treated as a partnership, the Form 1128 must be signed by a member-manager who has personal knowledge of the facts. In all other cases, the Form 1128 (Form 2553) must be signed by an authorized corporate officer.

(5) *No user fee*. No user fee is required for applications filed under this revenue procedure and, except as provided in section 9.01 of this revenue procedure, the receipt of an application filed under this revenue procedure may not be acknowledged.

(6) *Additional information*. In the case of a taxpayer changing to a natural business year that satisfies the 25-percent gross receipts test described in section 5.04 of this revenue procedure, the taxpayer must supply the gross receipts for the most recent 47 months for itself (or any predecessor) in compliance with the instructions to Form 1128 (or Form 2553).

.03 *Additional Procedures If Under Examination, Before an Area Office, or Before a Federal Court.*

(1) *Taxpayers under examination.*

(a) A taxpayer under examination may request approval to change or retain its annual accounting period under this revenue procedure only if the appropriate director consents to the change or retention. The director will consent to the change or retention unless, in the opinion of the director, the taxpayer's annual accounting period would ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the director will consent to a change where the taxpayer is using a clearly permissible annual accounting period. The director also will consent to a change from an impermissible annual accounting period where the period became impermissible (*e.g.*, due to a change in ownership or a change in the taxpayer's business) subsequent to the years under examination. The question of whether the taxpayer's annual accounting period from which the taxpayer is changing is permissible or became impermissible subsequent to the years under examination may be referred to the national

office as a request for technical advice under the provisions of Rev. Proc. 2001–2, 2001–1 I.R.B. 79 (or any successor).

(b) A taxpayer changing or retaining an annual accounting period under this revenue procedure with the consent of the appropriate director must attach to the application a statement from the director consenting to the change or retention. The taxpayer must provide a copy of the application to the director at the same time it files the application with the service center. The application must contain the name(s) and telephone number(s) of the examining officer(s).

(2) *Taxpayer before an area office*. A taxpayer that is before an area office must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the taxpayer's annual accounting period is not an issue under consideration by the area office. The taxpayer must provide a copy of the application to the appeals officer at the same time it files the application with the service center. The application must contain the name and telephone number of the appeals officer.

(3) *Taxpayer before a federal court*. A taxpayer that is before a federal court must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the taxpayer's annual accounting period is not an issue under consideration by the federal court. The taxpayer must provide a copy of the application to the government counsel at the same time it files the application with the service center. The application must contain the name and telephone number of the government counsel.

SECTION 8. EFFECT OF APPROVAL

.01 *Audit Protection.*

(1) *In general*. Except as provided in section 8.01(2) of this revenue procedure, a taxpayer that files an application in compliance with all the applicable provisions of this revenue procedure will not be required by the Service to change its annual accounting period for a taxable year prior to the first effective year.

(2) *Exceptions*. The Service may change a taxpayer's annual accounting period for a prior taxable year if:

(a) the taxpayer fails to implement the change,

(b) the taxpayer implements the change but does not comply with all the applicable provisions of this revenue procedure, or

(c) there was a misstatement or omission of material facts.

.02 *Subsequently Required Changes*.

(1) *In general*. A taxpayer that adopts, changes, or retains its annual accounting period pursuant to this revenue procedure may be required to subsequently change its annual accounting period for the following reasons:

(a) the enactment of legislation;

(b) a decision of the United States Supreme Court;

(c) the issuance of temporary or final regulations;

(d) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin;

(e) the issuance of written notice to the taxpayer that the change in annual accounting period was not in compliance with all the applicable provisions of this revenue procedure or is not in accord with the current view of the Service; or

(f) a change in the material facts on which the approval was granted.

(2) *Retroactive Change or Modification*. Except in rare circumstances, if a taxpayer that adopts, changes, or retains its annual accounting period under this revenue procedure is subsequently required under section 8.02(1) of this revenue procedure to change or modify that annual accounting period, the required change or modification will not be applied retroactively, provided that:

(a) the taxpayer complied with the applicable provisions of this revenue procedure;

(b) there has been no misstatement or omission of material facts;

(c) there has been no change in the material facts on which the consent was based;

(d) there has been no change in the applicable law; and

(e) the taxpayer to which the approval was granted acted in good faith in relying on the approval, and applying the change retroactively would be to the taxpayer's detriment.

SECTION 9. REVIEW OF APPLICATION

.01 *Service Center Review.* A Service Center may deny an application to adopt, change, or retain an annual accounting period under this revenue procedure only if: (1) the Form 1128 (or Form 2553) is not filed timely, or (2) the taxpayer fails to meet the scope or terms and conditions of this revenue procedure. If the application is denied, the Service Center will return the application with an explanation for the denial. In the case of a denial of an accounting period request filed on Form 2553, the corporation will be required to use the calendar year or, if applicable, make a § 444 election, if it chooses to be an S corporation.

.02 *Review of Director.* The director may ascertain if the adoption, change, or retention in annual accounting period was made in compliance with all the applicable provisions of this revenue procedure. Taxpayers adopting, changing, or retaining their annual accounting period pursuant to this revenue procedure without complying with all the provisions (including the terms and conditions) of this revenue procedure ordinarily will be deemed to have initiated the adoption, change, or retention in annual accounting period without the approval of the Commissioner. Upon examination, a taxpayer that has initiated an unauthorized adoption, change, or retention of annual accounting period may be denied the adoption, change, or retention. For example, the taxpayer may be required to recompute its taxable income or loss in accordance with its former (or required, if applicable) taxable year.

SECTION 10. EFFECTIVE DATE AND TRANSITION RULE

.01 *Effective Date.* This revenue procedure generally is effective for adoptions, changes, or retentions of annual accounting periods for which the first effective year ends on or after [INSERT DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE I.R.B.]. However, if the time period for filing Form 1128 (or Form 2553) with respect to a year set forth in section 7.02(2) of this revenue procedure has not yet expired, a taxpayer within the scope of this revenue procedure may elect early application of the

revenue procedure by providing the notification set forth in section 7.02(3) on the top of page 1 of Form 1128 (or Form 2553) and by satisfying the other procedural requirements of section 7.

.02 *Transition Rule.* If a taxpayer described in section 4 of this revenue procedure filed an application with the national office and the application is pending with the national office on [INSERT DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE I.R.B.], the taxpayer may obtain approval under this revenue procedure. However, the national office will process the application in accordance with the authority under which it was filed, unless by the later of [INSERT DATE THAT IS 45 DAYS FROM THE DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE I.R.B.] or the issuance of the letter ruling granting or denying approval for the adoption, change, or retention, the taxpayer notifies the national office that it wants to use this revenue procedure. If the taxpayer timely notifies the national office that it wants to use this revenue procedure, the national office will require the taxpayer to make appropriate modifications to the application to comply with the applicable provisions of this revenue procedure. In addition, any user fee that was submitted with the application will be refunded to the taxpayer.

SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 87–32 is modified, amplified, and superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Roy A. Hirschhorn of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Roy A. Hirschhorn at (202) 622-4960 (not a toll-free call).

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26 CFR 601.106: Appeals functions.
(Also Part I, §§ 4083, 6715; 48.4083–1.)

Rev. Proc. 2001–33

SECTION 1. PURPOSE AND SCOPE

.01 This revenue procedure informs taxpayers how to request an administrative appeal of the penalties imposed by § 6715 of the Internal Revenue Code relating to the misuse of dyed diesel fuel and kerosene (the Dyed Fuel Penalty) and §§ 4083(c)(3) and 7342 relating to the refusal to admit entry for purposes of inspecting facilities and equipment and taking and removing fuel samples (the Refusal Penalty). This revenue procedure also explains how the Office of Appeals (Appeals) resolves these appeals.

.02 An appeal request may be made to Appeals before payment of the Dyed Fuel Penalty or the Refusal Penalty according to the provisions of this revenue procedure. Special rules, which are described in section 7 of this revenue procedure, apply to taxpayers that paid a penalty before June 4, 2001, the date this revenue procedure is published in the Internal Revenue Bulletin.

.03 In all cases, an appeal request made under this revenue procedure is:

(1) Optional, and

(2) Initiated by the taxpayer.

SECTION 2. BACKGROUND

.01 *Section 6715.*

(1) Section 6715(a) provides that if any dyed fuel is sold or held for sale by any person for any use which such person knows or has reason to know is not a nontaxable use of such fuel; any dyed fuel is held for use or used by any person for a use other than a nontaxable use and such person knew, or had reason to know, that such fuel was so dyed; or any person willfully alters, or attempts to alter, the strength or composition of any dye or marking done pursuant to § 4082 in any dyed fuel, then such person shall pay a penalty in addition to the tax (if any).

(2) Section 6715(b)(1) provides that the amount of the penalty under § 6715(a) on each act shall be the greater of $10 for each gallon of dyed fuel involved or $1,000.

(3) Section 6715(b)(2) provides that in determining the penalty under § 6715(a) on any person, § 6715(b)(1) is applied by increasing the amount in § 6715(b)(1)(A) by the product of the amount and the number of prior penalties (if any) imposed by § 6715 on the person (or a related person or any predecessor of the person or related person).

(4) Section 6715(c) provides that "dyed fuel" means any dyed diesel fuel or kerosene, whether or not the fuel was dyed pursuant to § 4082. Also, "nontaxable use" has the same meaning given the term by § 4082(b).

(5) Section 6715(d) provides that if a penalty is imposed under § 6715 on any business entity, each officer, employee, or agent of the entity who willfully participated in any act giving rise to the penalty shall be jointly and severally liable with the entity for the penalty.

.02 *Sections 4083, 7606, and 7342.*

(1) Section 4083(a)(1) provides that "taxable fuel" means gasoline, diesel fuel, and kerosene.

(2) Section 4083(c)(1) provides that the Secretary may, in administering compliance with the tax on taxable fuel, enter any place at which taxable fuel is produced or is stored (or may be stored) for purposes of examining the equipment used to determine the amount or composition of such fuel and the equipment used to store such fuel, and taking and removing samples of such fuel; and detain, for those purposes, any container which contains or may contain any taxable fuel.

(3) Section 7606 provides that the Secretary may enter any building or place where any articles subject to tax are made, produced, or kept so far as may be necessary for the purpose of examining the articles.

(4) Section 7342 provides that any owner of a building or place, or person having agency or superintendence of the same, who refuses to admit any officer or employee of the United States Treasury Department acting under authority of § 7606 or refuses to permit the officer or employee to examine the article or articles, shall, for every refusal, forfeit $500.

(5) Section 4083(c)(3) provides that the Refusal Penalty provided by § 7342 shall apply to any refusal to admit entry or other refusal to permit an action by the Secretary authorized by § 4083(c)(1), except that § 7342 is applied by substituting "$1,000" for "$500" for each refusal.

SECTION 3. ACTION BEFORE APPEALS CONSIDERATION

.01 If the Internal Revenue Service (IRS) proposes to assert either the Dyed Fuel Penalty or the Refusal Penalty against a taxpayer, the IRS will notify the taxpayer in writing. If the taxpayer does

not agree with the proposed penalty, the taxpayer will be asked to complete Form 12009, *Request for an Informal Conference and Appeals Review*, and submit it, within 30 days from the date of this notification, to the IRS supervisor responsible for the taxpayer's case. Form 12009 is included as an Appendix to this Revenue Procedure. If the taxpayer does not submit this form to the IRS within this 30 day period, the IRS will, in the case of the Dyed Fuel Penalty, assess the penalty or, in the case of the Refusal Penalty, take appropriate legal action to collect the penalty.

.02 If the taxpayer submits Form 12009 on a timely basis, the IRS supervisor responsible for the case will review the information submitted by the taxpayer on the taxpayer's Form 12009 and will contact the taxpayer to arrange a conference. If, after this conference, the IRS still proposes to assert the penalty, the IRS supervisor will so notify the taxpayer. The taxpayer then has 30 days from the date of this notification to request that the case be reviewed by Appeals. The taxpayer makes this request by contacting the IRS supervisor who will then forward the case to Appeals. An Appeals Officer will then contact the taxpayer and, if necessary, arrange for a conference in Appeals.

SECTION 4. ISSUES FOR APPEALS CONSIDERATION

.01 All issues that remain in dispute between a taxpayer and the IRS involving either the Dyed Fuel Penalty or the Refusal Penalty are appropriate for an administrative appeal.

.02 With respect to the Dyed Fuel Penalty, issues in dispute may include whether (1) the fuel involved in an alleged violation was dyed; (2) the taxpayer knew or had reason to know that the fuel was sold or held for sale for other than a nontaxable use (in a case involving § 6715(a)(1)); (3) the taxpayer knew or had reason to know that the fuel was dyed (in a case involving § 6715(a)(2)); (4) the taxpayer acted willfully (in a case involving § 6715(a)(3)); (5) the officer, employee, or agent of a business entity willfully participated in any act giving rise to the Dyed Fuel Penalty under § 6715(d); or (6) the IRS correctly determined the amount of fuel subject to the Dyed Fuel Penalty.

.03 With respect to the Refusal Penalty, issues in dispute may include whether the IRS had authority to make the inspection in question.

SECTION 5. RESOLVING THE PENALTY

.01 *In general*. Case files transferred to Appeals should include the computation of the penalty; date, location, and type of violation; results of laboratory and field testing of fuel (if applicable); prior warnings and offenses; and statements made by the investigating official, the IRS supervisor, and the taxpayer.

.02 *Collection activity*. Since Appeals jurisdiction and consideration will be afforded to the taxpayer before the final determination of the penalty, collection activity will be suspended until Appeals has determined the penalty amount.

.03 Appeals determination. Each case will be reviewed under established Appeals procedures and decided on its own merits.

.04 *New information submitted.*

(1) The IRS should be given the opportunity to timely review and comment on any significant new information or evidence presented by the taxpayer. "Significant new information" is information of a non-routine nature that, in the judgement of the appeals officer, would have had an effect on the IRS's findings or that changes the appeals officer's evaluation of the litigating hazards. If it appears the significant new information or evidence was purposely withheld from the IRS, the entire case should be returned to the IRS and jurisdiction relinquished. See Internal Revenue Manual 8.2.1.2.2.

(2) If evidence submitted in Appeals conflicts with evidence originally submitted to the IRS or shifts responsibility to another taxpayer, and this new evidence was not purposely withheld from the IRS, consideration should be given to retaining jurisdiction but referring the new issues or information to the IRS for timely review and comment.

.05 *If the Dyed Fuel Penalty is upheld*. If the Dyed Fuel Penalty is upheld, Appeals will prepare an Appeals Case Memorandum and forward it along with the case file to the IRS office that proposed the Dyed Fuel Penalty so that the Dyed Fuel Penalty may be assessed and collected.

.06 *If the Dyed Fuel Penalty is not upheld*. If the Dyed Fuel Penalty is not upheld, Appeals will prepare an Appeals Case Memorandum and forward it along with the case file to the IRS office that proposed the penalty to close the Dyed Fuel Penalty case without assessing a penalty.

.07 *If the Refusal Penalty is upheld*. If the Refusal Penalty is upheld, Appeals will forward the case file to District Counsel for advice and direction on penalty enforcement.

.08 *If the Refusal Penalty is not upheld.* If the Refusal Penalty is not upheld, Appeals will prepare an Appeals Case Memorandum and forward it along with the case file to the IRS office that proposed the penalty to close the Refusal Penalty case.

.09 *Subsequent events*. If an excise tax assessment is made in conjunction with the Dyed Fuel Penalty, a copy of the Appeals Case Memorandum on the Dyed Fuel Penalty should be included in the case file. Any redeterminations of the excise tax issue and the Dyed Fuel Penalty will be based on the respective merits of each case.

SECTION 6. USER FEE

There is no user fee for an administrative appeal of the Dyed Fuel Penalty or the Refusal Penalty.

SECTION 7. TAXPAYERS THAT PAID A PENALTY BEFORE JUNE 4, 2001, THE DATE THIS REVENUE PROCEDURE IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN

.01 For purposes of this section, a "prior taxpayer" is a taxpayer that paid the Dyed Fuel Penalty or the Refusal Penalty before June 4, 2001 (the date this revenue procedure is published in the Internal Revenue Bulletin), was denied an administrative appeal, and has not signed a closing agreement with respect to the penalty.

.02 A prior taxpayer that files a timely claim for a refund of a penalty may request an administrative appeal. The refund claim should state that the prior taxpayer desires an administrative appeal under this revenue procedure. Appeals will process this request under the provisions of sections 4, 5.01, 5.03, and 5.04 of this revenue procedure.

SECTION 8. EFFECTIVE DATE

This revenue procedure applies to requests for appeal of the Dyed Fuel Penalty or the Refusal Penalty made on or after June 4, 2001, the date this revenue procedure is published in the Internal Revenue Bulletin.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Theodore J. Cichaski of the National Office of Appeals, Office of Alternative Dispute Resolution and Customer Service Programs, and Mary Burwell of the National Office (Examination) Excise Tax Program. For further information regarding this revenue procedure, contact Theodore J. Cichaski at (703) 756-6697, extension 18, Mary Burwell at (202) 622-4379, or Thomas Carter Louthan, Director, Office of Alternative Dispute Resolution and Customer Service Programs, at (202) 694-1842 (not toll-free numbers).

Form 12009 (March 1999)	Request for an Informal Conference and Appeals Review

Use this form to request an informal conference with an IRS supervisor. After your request is received and reviewed, the supervisor will contact you. If this matter is not resolved at the supervisor level, at your request, we will send your case to the appropriate Appeals Office for an administrative appeal.

Taxpayer Name(s):_____
Address:_____
_____
_____

Taxpayer Identification Number:_____

Enter the IRS dyed fuel or refusal penalty you do not agree with and tell us why you don't agree. Please attach any supporting documentation, and add more pages if you need additional space.

IRS Penalty :_____ Penalty Date:_____
_____
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_____

Signature_____ **Print Name**_____
Date_____ **Title**_____
Your Telephone Number(s)_____
Best Time for Us to Call _____

Send this completed form and any additional information to:

Internal Revenue Service
Manager Name & I.D. #
Address:

.....**Official Use Only**.....

Date of Taxpayer Request for Appeals Review _____ (Supervisor date and Initial)

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, sections 704; 1.704–1, 1.704–3.)

Rev. Proc. 2001–36

SECTION 1. PURPOSE

This revenue procedure grants automatic permission for certain securities partnerships to aggregate contributed property for purposes of making § 704(c) allocations. This revenue procedure also describes the information that must be included with ruling requests for permission to aggregate contributed property for purposes of making § 704(c) allocations submitted by partnerships that do not qualify for automatic permission.

SECTION 2. BACKGROUND

.01 To prevent the shifting of tax consequences among partners with respect to precontribution gain or loss, § 704(c) requires partnerships to allocate income, gain, loss, and deductions with respect to property contributed by a partner so as to take into account any variation between the adjusted tax basis of the property and its fair market value at the time of the contribution. These allocations must be made using a reasonable method that is consistent with the purpose of § 704(c). Similar rules apply to differences between book value and tax basis that are created by a revaluation of partnership assets pursuant to § 1.704–1(b)(2)(iv)(f) (reverse § 704(c) allocations).

.02 Section 1.704–3(a)(10) provides that an allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse § 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

.03 Section 1.704–3(a)(2) provides that § 704(c) allocations are generally made on a property-by-property basis. Therefore, built-in gains and losses from different items of contributed or revalued property generally cannot be aggregated.

.04 Section 1.704–3(e)(3) provides a special rule that allows securities partnerships (as defined in § 1.704–3(e)(3)(iii)) to make reverse § 704(c) allocations on an aggregate basis. Specifically, § 1.704–3(e)(3)(i) provides that, for purposes of making reverse § 704(c) allocations, a securities partnership may aggregate built-in gains and losses from qualified financial assets (as defined in § 1.704–3(e)(3)(ii)) using any reasonable approach that is consistent with the purpose of § 704(c). This rule, however, only applies to built-in gains and losses from revaluations of partnership property; aggregation of built-in gains and losses from contributed property is only permitted pursuant to published guidance or by letter ruling. Section 1.704–3(e)(4)(iii).

.05 Section 1.704–3(e)(3)(iv) and (v) describe two methods of making § 704(c) allocations on an aggregate basis that are generally reasonable, the partial netting and the full netting approaches, respectively.

.06 Since the regulations under § 704(c) were issued, the Service has received and responded to numerous ruling requests from securities partnerships organized as part of a "Master-Feeder Structure" for permission to aggregate contributed property for purposes of making § 704(c) and reverse § 704(c) allocations.

.07 In a typical Master-Feeder Structure, two or more Feeder Funds or one or more Feeder Funds and an investment advisor, principal underwriter, or manager contribute their assets, consisting primarily of cash or financial investments, to a single Master Portfolio in exchange for beneficial interests in the Master Portfolio. In these cases, each Feeder Fund and the Master Portfolio is registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (1940 Act). The shares of these Feeder Funds are typically publicly offered and widely held by individuals, corporations, and institutional investors. Generally, each Feeder Fund is an open-end mutual fund, which continuously offers to sell new shares or redeem existing shares for a price equal to the net asset value of their proportionate interest in the portfolio.

.08 The IRS and Treasury Department have determined that it is in the best interest of sound tax administration to reduce the burden on taxpayers of submitting ruling requests by granting to certain Master-Feeder Structures automatic permission to aggregate built-in gains and losses from contributed securities.

SECTION 3. SCOPE

.01 *Automatic Permission*. This revenue procedure provides automatic permission to Qualified Master-Feeder Structures (QMFSs), as described in section 4 of this revenue procedure, to aggregate built-in gains and losses from contributed securities for purposes of making § 704(c) and reverse § 704(c) allocations. The Service will no longer issue letter rulings to QMFSs allowing this type of aggregation. But see section 6.02 of this revenue procedure.

.02 *Securities Partnerships That Do Not Qualify for Automatic Permission*. The Service recognizes that there may be securities partnerships not described in section 4 of this revenue procedure that should be allowed to aggregate built-in gains and losses from contributed property where the burden of making § 704(c) allocations is great and the likelihood of character and timing distortions is minimal. Therefore, the Service will continue to consider ruling requests from these partnerships. Section 5 of this revenue procedure describes the information to be submitted in such a ruling request.

SECTION 4. AUTOMATIC PERMISSION FOR QUALIFIED MASTER-FEEDER STRUCTURES TO AGGREGATE CONTRIBUTED PROPERTIES

.01 *In general*. Permission is hereby granted for any QMFS, as defined in section 4.02 of this revenue procedure, to aggregate built-in gains and losses from contributed qualified financial assets for purposes of making § 704(c) and reverse § 704(c) allocations.

.02 *Qualified Master-Feeder Structure*. A QMFS is created where two or more investors contribute cash or qualified financial assets to a Master Portfolio in exchange for beneficial interests in the Master Portfolio. To qualify as a QMFS, the following requirements must be met:

(1) Each partner in the Master Portfolio is a Feeder Fund, or an investment advisor, principal underwriter, or manager of the Master Portfolio;

(2) Each Feeder Fund contributes only cash and/or a portfolio of diversified stocks and securities that satisfies the 25 and 50 percent tests of § 368(a)(2)(F)(ii) in exchange for beneficial interests in the Master Portfolio;

(3) Each partner in the Master Portfolio that is an investment advisor, principal underwriter, or manager, contributes only cash and/or services in exchange for beneficial interests in the Master Portfolio;

(4) The Master Portfolio is treated as a partnership for federal tax purposes and qualifies as a securities partnership under § 1.704–3(e)(3)(iii);

(5) Each Feeder Fund is a publicly offered regulated investment company, as defined in § 67(c)(2)(B) and § 1.67–2T (g)(3)(iii);

(6) The Master Portfolio is registered as an investment company under the 1940 Act.

(7) The Master Portfolio makes § 704(c) and reverse § 704(c) allocations under the partial netting approach or the full netting approach as described in § 1.704–3(e)(3)(iv) or § 1.704–3(e)(3)(v), respectively, and;

(8) The contributions to the Master Portfolio and the corresponding allocations of tax items with respect to the property contributed to the Master Portfolio are not made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

SECTION 5. INFORMATION REQUIRED FOR RULING REQUESTS BY SECURITIES PARTNERSHIPS THAT DO NOT QUALIFY FOR AUTOMATIC PERMISSION

.01 *In general.* This section describes the information and representations that a securities partnership not described in section 4 of this revenue procedure must submit when requesting a ruling permitting the aggregation of built-in gains and losses from contributed property for purposes of making § 704(c) and reverse § 704(c) allocations. Taxpayers should be aware that additional information may be required. See also section 8 of Rev. Proc. 2001–1, 2001–1 I.R.B. 1 (or its successor), which outlines the general requirements concerning the information to be submitted as part of a ruling request.

.02 *Representations*. The ruling request must include the following representations:

(1) The partnership qualifies as a "securities partnership" as defined in § 1.704–3(e)(3)(iii);

(2) The partnership will make revaluations at least annually in accordance with § 1.704–3(e)(3)(iii)(B)(2)(ii);

(3) The burden of making § 704(c) allocations separately from reverse § 704(c) allocations is substantial; and

(4) The partnership's contributions, revaluations, and the corresponding allocations of tax items are not made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that would substantially reduce the present value of the partners' aggregate tax liability.

.03 *Information*. The following information must be submitted with the ruling request:

(1) An explanation of the business and tax reasons for the formation of the partnership;

(2) A detailed description of each partner;

(3) A detailed description of each type of property to be contributed including its fair market value and adjusted basis;

(4) The aggregate fair market value and adjusted basis of the property to be contributed;

(5) The aggregate gross built-in gains and aggregate gross built-in losses in the property to be contributed;

(6) A representation that the partner is contributing all of its assets to the partnership or an explanation as to how the assets to be contributed to the partnership were chosen;

(7) A description of the aggregation method that the partnership will use;

(8) Copies of the partnership's organizational documents, if available; and

(9) Copies of any proxy statements, information statements, marketing materials, or prospectuses filed, distributed, or prepared by the partnership or any of its partners in connection with the formation of, or contribution of property to, the partnership.

SECTION 6. EFFECTIVE DATE

.01 *In general*. Section 4 of this revenue procedure applies to all contributions of property as part of a QMFS on or after June 4, 2001. Section 5 of this revenue procedure applies to all ruling requests pending in the National Office on June 4, 2001, and to requests received thereafter.

.02 *Transition rule for pending ruling requests*. If a QMFS has filed a request for a ruling allowing it to aggregate contributed securities for purposes of making § 704(c) and reverse § 704(c) allocations and that ruling request is pending in the national office on June 4, 2001, the QMFS may withdraw that ruling request and receive a refund of its user fee. However, the national office will process ruling requests pending on June 4, 2001, unless, prior to the earlier of July 19, 2001, or the issuance of the letter ruling, the QMFS notifies the national office that it will withdraw its ruling request.

DRAFTING INFORMATION

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

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26 CFR 601.105: Examination of returns and claims for refund; determination of correct tax liability.
(Also Part I, sections 942, 943.)

Rev. Proc. 2001–37

SECTION 1. PURPOSE

This revenue procedure provides guidance to taxpayers regarding certain elections made pursuant to the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (the "Act"). Pub. L. No. 106–519, 114 Stat. 2423 (Nov. 15, 2000). Specifically, this revenue procedure includes guidance with respect to the election to exclude gross receipts from foreign trading gross receipts under § 942(a)(3) of the Internal Revenue Code ("Code"), the election (and revocation of such election) by a foreign corporation to be treated as a domestic corporation under § 943(e)(1), and the election (and revocation of such election) by a taxpayer to apply the extraterritorial income exclu-

sion (the "ETI exclusion") in lieu of the foreign sales corporation ("FSC") provisions to certain transactions under § 5(c)(2) of the Act.

SEC. 2. BACKGROUND

.01 On November 15, 2000, the Act was signed into law, repealing the FSC provisions of §§ 921 through 927 effective October 1, 2000, and amending the definition of gross income to exclude certain extraterritorial income.

.02 The amendments to the Code made by the Act apply to all transactions entered into after September 30, 2000. Section 943(b)(1) defines the term "transaction" as "any sale, exchange, or other disposition . . . any lease or rental, and . . . any furnishing of services."

.03 Section 5(c)(1) of the Act provides a transition rule for FSCs in existence on September 30, 2000, whereby the FSC provisions remain applicable to FSC transactions for a limited transition period.

.04 The Act contains several taxpayer elections. First, a taxpayer may elect to exclude the gross receipts from a transaction or transactions from its "foreign trading gross receipts" in any taxable year under § 942(a)(3). Second, certain foreign corporations may elect to be treated as domestic corporations under § 943 (e)(1). Third, a taxpayer may elect under § 5(c)(2) of the Act to apply the ETI exclusion provisions in lieu of the FSC provisions to certain transactions otherwise covered by the transition rules.

SEC. 3. FORM 8873 ("EXTRATERRITORIAL INCOME EXCLUSION")

A taxpayer that reports extraterritorial income on its income tax return calculates its ETI exclusion with respect to that income on Form 8873 (*"Extraterritorial Income Exclusion"*). Such taxpayer must attach a completed Form 8873 to its income tax return.

SEC. 4. ELECTION TO EXCLUDE CERTAIN GROSS RECEIPTS FROM FOREIGN TRADING GROSS RECEIPT

A taxpayer may elect to exclude gross receipts from its "foreign trading gross receipts" in any taxable year under § 942(a)(3). A taxpayer makes a § 942 (a)(3) election on a transaction-by-transaction basis. A taxpayer makes such election by checking the box on line 1 in Part I of Form 8873 and attaching the completed form to its income tax return. In the case of a partnership, each partner may make this election with respect to any transaction for which the partnership maintains separate accounts. A taxpayer that excludes some, but not all, of its gross receipts from foreign trading gross receipts must attach to its Form 8873 a tabular schedule that identifies the gross receipts that are excluded from foreign trading gross receipts.

SEC. 5. ELECTION BY A FOREIGN CORPORATION TO BE TREATED AS A DOMESTIC CORPORATION

.01 *Generally*. Section 943(e)(1) allows an "applicable foreign corporation" to elect to be treated as a domestic corporation for all purposes of the Code if that corporation waives all benefits granted to it by the United States under any treaty. Making the election is a prerequisite to the ETI exclusion under § 943(a)(2) with respect to property manufactured, produced, grown, or extracted outside the United States by a foreign corporation. A corporation that makes a § 943(e)(1) election may not elect to be an S corporation under § 1362(a).

.02 *Who may elect*. Pursuant to § 943(e)(2), an applicable foreign corporation is any foreign corporation if either:

(1) it manufactures, produces, grows, or extracts property in the ordinary course of the corporation's trade or business, or

(2) substantially all of its gross receipts are foreign trading gross receipts.

03 *Period of election*. A § 943(e)(1) election applies to the taxable year for which made and to all subsequent years unless revoked by the taxpayer pursuant to § 943(e)(3)(A) or terminated pursuant to § 943(e)(3)(B). A § 943(e)(1) election may be filed after September 30, 2000, but cannot be effective for any taxable year beginning before October 1, 2000.

.04 *Method of election*. A corporation makes a § 943(e)(1) election by checking the box on line 3 in Part I of Form 8873 and attaching the completed form to a timely filed Form 1120 (*"U.S. Corporation Income Tax Return"*) (including extensions) for the first taxable year of the election.

.05 *Where return is filed*. A foreign corporation that makes a § 943(e)(1) election but does not become a member of a consolidated group under § 1501 as a result of such election shall file its Form 1120 at the applicable Service Center address listed in the "Where To File" section of the instructions for Form 1120. If a foreign corporation makes a § 943(e)(1) election and becomes a member of a consolidated group under § 1501 as a result of such election, the common parent of such group shall include the corporation that made the § 943(e)(1) election in its consolidated return (Form 1120) for the group.

.06 *Revocation of election.* A corporation may revoke a § 943(e)(1) election by filing a statement that the election is revoked. The revocation statement shall be entitled "Revocation of Election under Section 943(e)(1) to be Treated as a Domestic Corporation – Filed Pursuant to **[citation of this revenue procedure]**" and shall include the corporation's name, address, employer identification number, and contact phone number, and a statement that the taxpayer revokes its election under § 943(e)(1). The revocation statement shall be signed by any person authorized to sign a corporate return under § 6062. The corporation shall file such revocation statement with the same Service Center ("Attn: Entity Control") with which the corporation files its income tax return as determined under § 5.05 of this revenue procedure. Once properly filed, the revocation of a § 943(e)(1) election is automatic and applies to taxable years beginning on or after the date the revocation statement is filed.

.07 *Termination of election*. If a corporation that made a § 943(e)(1) election in any taxable year meets neither of the requirements described in § 5.02 of this revenue procedure for any subsequent taxable year, the election will not apply to taxable years beginning after such subsequent taxable year.

.08 *Effect of termination or revocation.* If a corporation that made a § 943(e)(1) election revokes the election or the election is terminated, that corporation (and any successor corporation) may not make another § 943(e)(1) election for five taxable years beginning with the first taxable

year for which the original election is not in effect as a result of the revocation or termination.

.09 *Effect of election by FSCs*. A FSC that elects to be treated as a domestic corporation under § 943(e)(1) is not treated as a FSC for any year for which such election applies and for all subsequent years.

.10 *Effect of election for purposes of section 367*.

(1) Except as provided in § 5.10(2) of this revenue procedure, a foreign corporation that makes a § 943(e)(1) election is treated, for purposes of § 367, as transferring, on the first day of the first taxable year to which the election applies, all of its assets to a domestic corporation in connection with an exchange described in § 354.

(2) In the case of a foreign corporation described in § 5(c)(3) of the Act that makes a § 943(e)(1) election, earnings and profits ("E&P") accumulated in taxable years ending before October 1, 2000, are not included in the gross income of its shareholders by reason of such election. This rule does not apply to E&P acquired by the foreign corporation in a transaction after September 30, 2000, that is subject to § 381, unless the E&P would have qualified for the exclusion under § 5(c)(3) of the Act in the hands of the transferor or distributor. Rules similar to rules under § 953(d)(4)(B)(ii) through (iv) shall apply to E&P not included in gross income under § 5(c)(3) of the Act.

.11 *Effect of revocation or termination for purpose of section 367*. If a corporation's § 943(e)(1) election ceases to apply because it is revoked or terminated, then, for purposes of § 367, such corporation shall be treated as a domestic corporation transferring all of its assets to a foreign corporation in connection with an exchange to which § 354 applies on the first day of the first taxable year to which the election ceases to apply.

SEC. 6. TRANSITION RULES; ELECTION TO APPLY EXTRATERRITORIAL INCOME EXCLUSION PROVISIONS IN LIEU OF FSC PROVISIONS

.01 *FSC elections*. After September 30, 2000, no corporation may elect to be a FSC under § 922(a)(2). For purposes of the transition rule, a FSC election is deemed to occur upon the formation of an otherwise eligible electing corporation, provided that the corporation makes the election within 90 days of formation pursuant to the requirements of § 1.921–1T (b)(1) of the Income Tax Regulations.

.02 *Termination of inactive FSCs*. If a FSC has no foreign trade income (as defined in former § 923(b)) for any period of five consecutive taxable years beginning after December 31, 2001, such FSC will no longer be treated as a FSC for any taxable year beginning after such five-year period.

.03 *Transition period for existing FSCs*. In general, the Act repeals the FSC provisions for transactions entered into after September 30, 2000. However, § 5(c)(1) of the Act provides that the FSC provisions continue to apply for a limited time period with respect to certain transactions entered into in the ordinary course of business involving a FSC in existence on September 30, 2000. Specifically, the FSC provisions continue to apply to transactions involving a FSC and occurring:

(1) before January 1, 2002, or

(2) after December 31, 2001, pursuant to a binding contract which is in effect on September 30, 2000, and thereafter, and which is between the FSC (or a person related to the FSC) and a person other than a related person.

.04 *Election to apply extraterritorial income provisions*. In the case of transactions occurring after September 30, 2000, for which the FSC provisions continue to apply pursuant to § 5(c)(1) of the Act, a taxpayer may elect under § 5(c)(2) of the Act to apply the ETI exclusion provisions in lieu of the FSC provisions. A taxpayer makes a § 5(c)(2) election on a transaction-by-transaction basis. Such election with respect to a transaction is effective for the taxable year for which made and all subsequent taxable years.

.05 *Method of election*. A § 5(c)(2) election is made by checking the box on line 2 in Part I of Form 8873 on which the taxpayer determines its ETI exclusion and attaching the completed form to the taxpayer's timely filed income tax return (including extensions) for the first taxable year of the election. As set forth in Form 8873 and the accompanying instructions, the taxpayer shall attach to Form 8873 a tabular schedule that identifies the transactions for which the taxpayer has elected ETI exclusion treatment pursuant to § 5(c)(2) of the Act.

.06 *Method of revocation*. A taxpayer may revoke a § 5(c)(2) election with respect to a transaction only with the consent of the Secretary of the Treasury. To request consent for a § 5(c)(2) revocation, the taxpayer shall file a statement entitled "Revocation of Election under Section 5(c)(2) of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 – Filed Pursuant to **[citation of this revenue procedure]**" requesting revocation of the § 5(c)(2) election. Until regulations are issued, such statement shall include the name, address, taxpayer identification number, and contact phone number of the taxpayer, the Service Center with which the taxpayer filed its last income tax return, the first taxable year of the taxpayer for which the revocation is to be effective, and reasons justifying the granting of consent for the § 5(c)(2) revocation. In addition, the statement shall indicate the transactions to which the request for consent to revoke the § 5(c)(2) election applies. The statement shall be signed by, or on behalf of, the taxpayer requesting consent by an individual with authority to bind the taxpayer in such matters. The taxpayer shall file such statement with Internal Revenue Service, 1111 Constitution Ave. NW, LMSB Mint Bldg., Room M3-333 LM:PFT:I, Washington, DC 20224. A § 5(c)(2) revocation applies to taxable years beginning after the year in which such revocation is requested.

SEC. 7. EFFECTIVE DATE

This revenue procedure is effective October 1, 2000.

SEC. 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Christopher J. Bello of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Mr. Bello at (202) 874-1490 (not a toll-free call).

SEC. 9. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Of-

fice of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1731.

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

The collections of information in this revenue procedure are in §§ 3, 4, 5, and 6. The collections in §§ 4, 5 and 6 are required for a taxpayer that elects to exclude some, but not all, of its gross receipts from foreign trading gross receipts for purposes of the ETI exclusion provisions; for a corporation subject to an election to be treated as a domestic corporation to revoke such election; for a taxpayer that elects to apply the ETI exclusion provisions to its transactions in lieu of the FSC provisions; and for a taxpayer subject to an election to apply the ETI exclusion provisions, in lieu of the FSC provisions, to revoke such election. The likely respondents are businesses.

The estimated total annual reporting burden in §§ 5.06 and 6.06 with respect to the revocation of the above elections is 19 hours. The estimated annual burden per respondent is 20 minutes. The estimated number of respondents is 56. The estimated annual frequency of responses is once.

The estimated average annual burden per respondent required in §§ 3, 4, 5.04, and 6.05 is reflected in the burden of Form 8873.

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.

Part IV. Items of General Interest

General Rules and Specifications for Private Printing of Substitute Forms W-2 and W-3; Correction

Announcement 2001–59

The document contains corrections to Rev. Proc. 2001–26 (2001–17 I.R.B. 1093).

Need for Correction

As published, Rev. Proc. 2001–26 contains the following errors that may prove to be misleading and are in need of clarification.

1. On page 1096, PART A, SEC. 4, paragraph #.08; the language "If employers submit MMREF–1 file on magnetic tape cartridge, a Form 6559 is required." is corrected to read: "If employers submit MMREF–1 file on magnetic tape or tape cartridge, a Form 6559 is required.

2. On page 1100, PART B, SEC. 2, Paragraph #.05, #4; the language "Also, if an employer will only be reporting amounts for a 401(k) plan in box 13, those instructions may be modified to cover only Code D and its instructions." is corrected to read: "Also, if an employer will only be reporting amounts for a 401(k) plan in box 12, those instructions may be modified to cover only Code D and its instructions."

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

EMPLOYEE PLANS

EMPLOYMENT TAX

ESTATE TAX

EXCISE TAX

EXEMPT ORGANIZATIONS

GIFT TAX

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