Internal Revenue
bulletin

Bulletin No. 2009-28
July 13, 2009

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.

SPECIAL ANNOUNCEMENT

Announcement 2009–56, page 145.

The IRS has developed six (6) new security, privacy, and business standards to better protect taxpayer information collected, processed and stored by Authorized IRS e-file Providers participating in Online Filing of Individual income tax returns. The security and privacy objectives of these standards are: setting minimum encryption standards for transmission of taxpayer information over the internet and authentication of Web site owners/operators beyond that offered by standard version SSL certificates; periodic external vulnerability scan of the taxpayer data environment; protection against bulk-filing of fraudulent tax returns; and the ability to timely isolate and investigate potentially compromised taxpayer information. These standards also address certain customer service objectives such as instant access to Web site owner/operator's contact information, and e-file Providers commitment to maintaining physical, electronic, and procedural safeguards that comply with applicable law and federal standards.

INCOME TAX

Rev. Rul. 2009–19, page 111.

Home Affordable Modification Program (HAMP). This ruling holds that Pay-for-Performance Success Payments that benefit a homeowner under the United States Government's Home Affordable Modification Program (HAMP) are excludable from the homeowner's income under the general welfare exclusion.

Rev. Rul. 2009–20, page 112.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for July 2009.

T.D. 9453, page 114.
REG–112994–06, page 144.

Final, temporary, and proposed regulations under section 7874 of the Code relate to the determination of whether a foreign corporation is treated as a surrogate foreign corporation pursuant to section 7874(a)(2)(B). Notice 2006–70 obsoleted.

Notice 2009–51, page 128.

This notice solicits applications for allocations of the national bond volume limitation authority ("volume cap") of $2 billion to issue tribal economic development bonds (TEDBs) under section 7871(f) of the Code. This notice also provides related guidance on the (1) eligibility requirements that a project must meet to be considered for a volume cap allocation; (2) application requirements and the application form for requests for volume cap allocations; and (3) the method that the IRS will use to allocate the volume cap.

EXEMPT ORGANIZATIONS

Rev. Proc. 2009–32, page 142.

This procedure provides reliance criteria to private foundations and sponsoring organizations that maintain donor advised funds in determining whether a potential grantee is a supporting organization described in section 509(a) of the Code. Notice 2006–109 superseded in part.

Finding Lists begin on page ii.

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 compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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

The Bulletin is divided into four parts as follows:

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

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

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

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2009. See Rev. Rul. 2009-20, page 112.

Section 61.—Gross Income Defined

26 CFR 1.61–1(a): Gross income.

Home Affordable Modification Program (HAMP). This ruling holds that Pay-for-Performance Success Payments that benefit a homeowner under the United States Government's Home Affordable Modification Program (HAMP) are excludable from the homeowner's income under the general welfare exclusion.

Rev. Rul. 2009–19

ISSUE

If a homeowner benefits from Pay-for-Performance Success Payments under the United States Government's Home Affordable Modification Program (HAMP), are those payments excludable from income under the general welfare exclusion?

FACTS

The deep contraction in the economy and in the housing market has created stress for homeowners throughout the country. Large numbers of homeowners are struggling to afford their current monthly mortgage payments and are at risk of losing their homes. In response, the United States Government announced the Homeowner Affordability and Stability Plan (the Plan), which helps at-risk homeowners modify their mortgages to avoid foreclosure.

HAMP, a key component of the Plan, helps homeowners who have defaulted, or are at risk of default, on their mortgages because, for example, they are suffering serious hardships, decreases in income, increases in expenses, and high mortgage debt compared to monthly income.

Under HAMP, homeowners that make timely payments on their modified loans are eligible to have incentive payments made on their behalf to lenders/investors. Each month that a homeowner makes a mortgage payment on time, the homeowner accrues an amount toward a Pay-for-Performance Success Payment. A payment of the accrued amounts is made annually, to reduce the principal balance on the homeowner's mortgage loan. Homeowners can receive principal reductions of up to $1,000 per year for up to five years, subject to a *de minimis* threshold.

The Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation have a substantial role in administering HAMP.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived. Payments under governmental social benefit programs for the promotion of the general welfare and not for services rendered, however, are not includible in a recipient's gross income (general welfare exclusion). *See* Rev. Rul. 74–205, 1974–1 C.B. 20; Rev. Rul. 98–19, 1998–1 C.B. 840.

Pay-for-Performance Success Payments made under the United States Government's Home Affordable Modification Program promote the general welfare by helping homeowners who are at risk of losing their homes pay the mortgage loans on their primary residences and do not involve the performance of services. These payments meet the requirements of the general welfare exclusion.

HOLDING

If a homeowner benefits from Pay-for-Performance Success Payments under the United States Government's Home Affordable Modification Program, the payments are excludable from income under the general welfare exclusion.

DRAFTING INFORMATION

The principal author of this revenue ruling is Sheldon Iskow of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Iskow at (202) 622–4920 (not a toll-free number).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2009. See Rev. Rul. 2009-20, page 112.

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

The adjusted applicable federal long-term rates is set forth for the month of July 2009. See Rev. Rul. 2009-20, page 112.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2009. See Rev. Rul. 2009-20, page 112.

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 July 2009. See Rev. Rul. 2009-20, page 112.

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 July 2009. See Rev. Rul. 2009-20, page 112.

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 July 2009. See Rev. Rul. 2009-20, page 112.

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 July 2009. See Rev. Rul. 2009-20, page 112.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2009. See Rev. Rul. 2009-20, page 112.

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 July 2009. See Rev. Rul. 2009-20, page 112.

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 July 2009. See Rev. Rul. 2009-20, page 112.

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

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

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for July 2009.

Rev. Rul. 2009–20

This revenue ruling provides various prescribed rates for federal income tax purposes for July 2009 (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)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before December 31, 2013, shall not be less than 9%. 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. Finally, Table 6 contains the blended annual rate for 2009 for purposes of section 7872.

REV. RUL. 2009–20 TABLE 1

Applicable Federal Rates (AFR) for July 2009

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	.82%	.82%	.82%	.82%
110% AFR	.90%	.90%	.90%	.90%
120% AFR	.98%	.98%	.98%	.98%
130% AFR	1.07%	1.07%	1.07%	1.07%
Mid-term				
AFR	2.76%	2.74%	2.73%	2.72%
110% AFR	3.03%	3.01%	3.00%	2.99%
120% AFR	3.32%	3.29%	3.28%	3.27%
130% AFR	3.59%	3.56%	3.54%	3.53%
150% AFR	4.15%	4.11%	4.09%	4.08%
175% AFR	4.86%	4.80%	4.77%	4.75%
Long-term				
AFR	4.36%	4.31%	4.29%	4.27%
110% AFR	4.80%	4.74%	4.71%	4.69%
120% AFR	5.24%	5.17%	5.14%	5.12%
130% AFR	5.68%	5.60%	5.56%	5.54%

REV. RUL. 2009–20 TABLE 2

Adjusted AFR for July 2009

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	.84%	.84%	.84%	.84%
Mid-term adjusted AFR	2.22%	2.21%	2.20%	2.20%
Long-term adjusted AFR	4.33%	4.28%	4.26%	4.24%

REV. RUL. 2009–20 TABLE 3

Rates Under Section 382 for July 2009

Adjusted federal long-term rate for the current month	4.33%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.58%

REV. RUL. 2009–20 TABLE 4

Appropriate Percentages Under Section 42(b)(1) for July 2009

Note: Under Section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before December 31, 2013, shall not be less than 9%.

Appropriate percentage for the 70% present value low-income housing credit	7.82%
Appropriate percentage for the 30% present value low-income housing credit	3.35%

REV. RUL. 2009–20 TABLE 5	
Rate Under Section 7520 for July 2009	
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	3.4%

REV. RUL. 2009–20 TABLE 6	
Blended Annual Rate for 2009	
Section 7872(e)(2) blended annual rate for 2009	0.82%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2009. See Rev. Rul. 2009-20, page 112.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2009. See Rev. Rul. 2009-20, page 112.

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 July 2009. See Rev. Rul. 2009-20, page 112.

Section 7874.—Rules Relating to Expatriated Entities and their Foreign Parents

26 CFR 1.7874–2T: Surrogate foreign corporation (temporary).

T.D. 9453

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Guidance Under Section 7874 Regarding Surrogate Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations under section 7874 of the Internal Revenue Code (Code) concerning the determination of whether a foreign corporation shall be treated as a surrogate foreign corporation. The temporary regulations primarily affect domestic corporations or partnerships (and certain parties related thereto), and certain foreign corporations that acquire substantially all of the properties of such domestic corporations or partnerships. The text of these temporary regulations serves as the text of the proposed regulations (REG–112994–06) set forth in the notice of proposed rulemaking on this subject also published in this issue of the Bulletin.

DATES: *Effective Dates:* The regulations are effective on June 12, 2009.

Applicability Date: For dates of applicability, see §§1.7874–1T(g) and 1.7874–2T(o).

FOR FURTHER INFORMATION CONTACT: S. James Hawes, (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

A foreign corporation is generally treated as a surrogate foreign corporation under section 7874(a)(2)(B) if pursuant to a plan (or a series of related transactions) three conditions are satisfied. First, the foreign corporation completes after March 4, 2003, the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation. Second, after the acquisition at least 60 percent of the stock (by vote or value) of the foreign corporation is held by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation. Third, after the acquisition the expanded affiliated group (defined in section 7874(c)(1)) that includes the foreign corporation does not have substantial business activities in the foreign country in which, or under the law of which, the foreign corporation is created or organized, when compared to the total business activities of the expanded affiliated group. Similar provisions apply to transactions involving the acquisition by a foreign corporation of substantially all of the properties constituting a trade or business of a domestic partnership. The level of ownership in the surrogate foreign corporation by former shareholders of the

domestic corporation (or former partners in the domestic partnership) determines the treatment of the transaction. Compare sections 7874(a)(1) and 7874(b).

Temporary regulations (T.D. 9265, 2006–2 C.B. 1) were published in the **Federal Register** (71 FR 32437) on June 6, 2006, concerning the treatment of a foreign corporation as a surrogate foreign corporation (2006 temporary regulations). A notice of proposed rulemaking (REG–112994–06, 2006–2 C.B. 47) cross-referencing the temporary regulations was published in the same issue of the **Federal Register** (71 FR 32495). On July 28, 2006, Notice 2006–70, 2006–2 C.B. 252, (see §601.601(d)(2)(ii)(*b*)) was published, announcing that the effective date in §1.7874–2T(j) would be amended for certain acquisitions initiated prior to December 28, 2005. No public hearing was requested or held; however, comments were received. After consideration of the comments, the 2006 temporary regulations and the related notice of proposed rulemaking are withdrawn and replaced with new temporary regulations and a new notice of proposed rulemaking. These new temporary regulations are discussed in this preamble.

Summary of Temporary Regulations

A. *Stock Held by a Partnership*

Section 1.7874–1T(b), as contained in 26 CFR part 1 revised as of April 1, 2008, provided that, for purposes of section 7874(c)(2)(A), stock held by a partnership shall be considered as held proportionately by the partners of the partnership. Final regulations published in the **Federal Register** (T.D. 9399, 2008–25 I.R.B. 1157 [73 FR 29054–29058]) on May 20, 2008 (2008 final regulations) modified this provision to apply for all purposes of section 7874. See §1.7874–1(e). By its terms, §1.7874–1(e) applies only to stock held by a partnership, not to all properties held by the partnership.

Commentators have questioned the scope of §1.7874–1(e). In response to these comments, the temporary regulations modify the rule to apply only for purposes of determining whether the ownership condition of section 7874(a)(2)(B)(ii) is satisfied. The temporary regulations provide other partnership look-through rules, as appropriate. See, for example, the discussion in section F.4. of this preamble concerning the partnership items that are taken into account for purposes of section 7874(a)(2)(B)(iii).

B. *Indirect Acquisition of Properties*

1. *Clarification of Temporary Regulations*

The 2006 temporary regulations identify certain acquisitions that constitute indirect acquisitions of properties held by a domestic corporation. See §1.7874–2T(b). The temporary regulations retain these rules and clarify that the identified transactions do not represent an exclusive list of transactions that constitute indirect acquisitions. The temporary regulations also clarify that the acquisition of an interest in a partnership is an indirect acquisition of a proportionate amount of the properties of the partnership for purposes of section 7874(a)(2)(B)(i).

2. *Certain Acquisitions by Members of the Expanded Affiliated Group*

The 2006 temporary regulations provide that if a corporation (acquiring corporation) acquires stock or assets of a domestic corporation in exchange for stock of a foreign corporation (foreign issuing corporation) that directly or indirectly owns more than 50 percent of the stock (by vote or value) of the acquiring corporation after the acquisition, the foreign issuing corporation shall be treated as acquiring a proportionate amount of the stock or assets of the domestic corporation. §1.7874–2T(b)(4).

The temporary regulations retain this rule, with modifications. First, the rule is modified to apply if the acquiring corporation and the foreign issuing corporation are members of the same expanded affiliated group after the acquisition. Second, the rule is modified to apply to an acquisition of properties of a partnership. Finally, the rule is modified to apply if a partnership acquires properties of a domestic corporation (or partnership) in exchange for stock of a foreign issuing corporation, but only if the foreign issuing corporation and the partnership would be members of the same expanded affiliated group after the acquisition if the partnership were a corporation.

C. *Acquisitions by Multiple Foreign Corporations*

The IRS and the Treasury Department have become aware of transactions intended to avoid section 7874 that involve two or more foreign corporations completing, in the aggregate, an acquisition described in section 7874(a)(2)(B)(i). For example, pursuant to a plan (or a series of related transactions), two foreign corporations would collectively acquire substantially all of the properties held by a domestic corporation. Taxpayers may take the position that neither foreign corporation is a surrogate foreign corporation because no foreign corporation separately acquires substantially all of the properties held by the domestic corporation. Taxpayers may also take the position that section 7874(c)(4) does not apply to these transactions.

Even if substantially all of the properties held by a domestic corporation (or constituting a trade or business of a domestic partnership) are not acquired by a single foreign corporation, this type of transaction presents the policy concerns that prompted the enactment of section 7874. Accordingly, the temporary regulations provide that, if pursuant to a plan (or a series of related transactions) two or more foreign corporations complete, in the aggregate, an acquisition described in section 7874(a)(2)(B)(i), then each foreign corporation shall be treated as completing the acquisition for purposes of determining whether such foreign corporation shall be treated as a surrogate foreign corporation. See also section 7874(c)(4).

D. *Acquisition of Multiple Domestic Corporations (or Partnerships)*

The preamble to the 2008 final regulations identifies another transaction intended to avoid section 7874 that involves a single foreign corporation completing more than one acquisition described in section 7874(a)(2)(B)(i) as part of the same plan (or a series of related transactions). The preamble to the 2008 final regulations explains that the IRS and the Treasury Department disagree with the characterization of this type of transaction for purposes of section 7874 under current law and are considering issuing regulations clarifying the application of section

7874 to such transactions. In particular, the IRS and the Treasury Department disagree with the position that in determining whether the foreign corporation is a surrogate foreign corporation the ownership percentage under section 7874(a)(2)(B)(ii) is determined separately with respect to each domestic corporation (or partnership).

The preamble to the 2008 final regulations explains that any regulations issued would clarify that references in section 7874(a)(2)(B) to "a domestic corporation" shall, as appropriate, mean "one or more domestic corporations" where the properties of more than one domestic corporation are, directly or indirectly, acquired by a foreign corporation pursuant to the same plan. See §1.368–2(h). The preamble indicates that similar clarifications would be made for transactions involving domestic partnerships.

The temporary regulations clarify that if a foreign corporation completes more than one acquisition described in section 7874(a)(2)(B)(i) pursuant to a plan (or a series of related transactions), then, for purposes of section 7874(a)(2)(B)(ii), the acquisitions shall be treated as a single acquisition and the domestic corporations (and/or domestic partnerships) shall be treated as a single entity. This rule shall apply equally to transactions involving multiple corporations, multiple partnerships, or multiple corporations and partnerships.

The IRS and the Treasury Department determined that providing a specific operative rule was preferable to simply stating that, for purposes of section 7874(a)(2)(B), any reference to a single domestic corporation (or partnership) includes one or more domestic corporations (or partnerships). However, the operative rule of the temporary regulations is not a change from current law.

E. *"By Reason of" Standard of Section 7874(a)(2)(B)(ii)*

1. *Distributions and Other Transactions*

The 2006 temporary regulations provide that stock of a foreign corporation received by a former shareholder of a domestic corporation in exchange for stock of the domestic corporation is held by reason of holding stock in the domestic corporation. §1.7874–2T(c)(1). Commentators have questioned whether an exchange is the exclusive means by which stock of a foreign corporation can be held by reason of holding stock in the domestic corporation. For example, one commentator questioned whether stock of a foreign corporation received by a former shareholder as a distribution with respect to the stock of the domestic corporation is held by reason of holding stock in the domestic corporation.

Section 7874(a)(2)(B)(ii) does not require stock of the foreign corporation to be received in exchange for stock of the domestic corporation (or an interest in the domestic partnership). Therefore, the temporary regulations clarify that the "by reason of" condition of section 7874(a)(2)(B)(ii) is satisfied if stock of a foreign corporation is received in exchange for, or with respect to, stock in a domestic corporation (or an interest in a domestic partnership). This includes a taxable or nontaxable distribution. The temporary regulations also clarify that the "by reason of" condition may be satisfied other than through exchanges or distributions.

2. *Acquisitions Involving Other Property*

One commentator questioned whether all the stock of a foreign corporation received by a former shareholder in exchange for stock of a domestic corporation and other property could be treated as held by reason of holding stock of the domestic corporation, if the other property bears some relationship to the stock of the domestic corporation.

In response to this comment, the temporary regulations clarify that, subject to section 7874(c)(4) and general tax principles, the "by reason of" standard applies based on the amount of stock of the foreign corporation received in exchange for, or with respect to, the stock of the domestic corporation (or interest in the domestic partnership). This determination is based on the relative values of the stock of the domestic corporation (or interest in a domestic partnership) and any other property exchanged for the stock of the foreign corporation. Thus, subject to section 7874(c)(4) and general tax principles, the "by reason of" standard is not affected by a relationship between stock of the domestic corporation (or interest in the domestic partnership) and such other property.

F. *Substantial Business Activities Condition of Section 7874(a)(2)(B)(iii)*

1. *Removal of Safe Harbor and Examples*

The third condition for the treatment of a foreign corporation as a surrogate foreign corporation is that, after the acquisition, the expanded affiliated group (defined in section 7874(c)(1)) that includes the foreign corporation does not have substantial business activities in the foreign country in which, or under the law of which, the foreign corporation is created or organized, when compared to the total business activities of the expanded affiliated group (the substantial business activities condition). Section 7874(a)(2)(B)(iii). For purposes of determining whether the substantial business activities condition is satisfied, the 2006 temporary regulations provide a general rule that, with certain exceptions, is based on all the facts and circumstances, and a safe harbor. §1.7874–2T(d)(1) through (3). The 2006 temporary regulations also provide examples illustrating the application of the general rule. §1.7874–2T(d)(4).

The IRS and the Treasury Department have concluded that the safe harbor provided by the 2006 temporary regulations may apply to certain transactions that are inconsistent with the purposes of section 7874, which is meant to prevent certain transactions that seek to avoid U.S. tax by merely shifting the place of organization of a domestic corporation (or partnership). The temporary regulations, therefore, do not retain the safe harbor provided by the 2006 temporary regulations. The temporary regulations also do not retain the examples illustrating the general rule contained in the 2006 temporary regulations. Thus, taxpayers can no longer rely on the safe harbor or the examples illustrating the general rule provided by the 2006 temporary regulations. Instead, taxpayers must apply the general rule to determine whether the substantial business activities condition is satisfied. In addition, the question of whether the substantial business activities condition is satisfied will continue to be on the list of provisions with respect to which the IRS will not ordinarily issue rulings or determination letters.

See Rev. Proc. 2009–7, 2009–1 I.R.B. 226, Section 4.01(30). Comments are requested with respect to these changes.

2. *Sales and Services Between Expanded Affiliated Group Members*

The 2006 temporary regulations identify sales made by the expanded affiliated group to customers located in the foreign country as an item to consider in determining whether the substantial business activities condition is satisfied. §1.7874–2T(d)(1)(ii)(*3*). Commentators have asked whether sales (or the performance of services) between expanded affiliated group members may be taken into account for this purpose.

The IRS and the Treasury Department are concerned that sales (and the performance of services) between expanded affiliated group members can be structured in a manner that does not represent actual business activities. However, subject to section 7874(c)(4) and general tax principles, the IRS and the Treasury Department believe that in appropriate circumstances sales (or the performance of services) between members of the expanded affiliated group may be taken into account under the general rule.

3. *Items Not to Be Considered*

The 2006 temporary regulations identify certain assets, activities, or income not to be taken into account in determining whether the substantial business activities condition is satisfied. See §1.7874–2T(d)(1)(iii). See also section 7874(c)(4). The temporary regulations add to these items any assets, business activities, or employees located in the foreign country in which, or under the law of which, the foreign acquiring corporation is created or organized if such assets, business activities or employees are transferred to another country pursuant to a plan in existence at the time of the acquisition.

4. *Partnership Items*

The 2006 temporary regulations provide that if one or more members of the expanded affiliated group own capital or profits interests in a partnership, the proportionate amount of certain items of the partnership are considered to be items of the member (or members) of the expanded affiliated group. §1.7874–2T(d)(3)(iv).

The temporary regulations retain and modify this provision to provide that, for purposes of the substantial business activities condition, a member of the expanded affiliated group that holds at least a 10 percent capital and profits interest in a partnership shall take into account its proportionate share of the items of the partnership, including business activities, employees, assets, income, and sales.

G. *Publicly Traded Foreign Partnerships*

1. *Scope*

For purposes of section 7874, the 2006 temporary regulations treat as a foreign corporation any foreign partnership that would, but for section 7704(c), be treated as a corporation under section 7704 at any time during the two-year period following the completion by the foreign partnership of an acquisition described in section 7874(a)(2)(B)(i). The IRS and the Treasury Department are concerned that taxpayers may be taking the position that the rule does not apply to a foreign partnership whose interests become publicly traded outside this two-year period, even if the public trading occurs pursuant to a plan that existed at the time of the acquisition.

To address these transactions, the temporary regulations modify the rule to apply to any foreign partnership that would, but for section 7704(c), be treated as a corporation under section 7704(a) at the time of the acquisition described in section 7874(a)(2)(B)(i), or at any time after the acquisition pursuant to a plan that existed at the time of the acquisition. For this purpose, a plan shall be deemed to exist at the time of the acquisition if the foreign partnership would, but for section 7704(c), be treated as a corporation under section 7704(a) at any time during the two-year period following the acquisition.

The temporary regulations also clarify that a publicly traded foreign partnership treated as foreign corporation under the rule is treated as a foreign corporation for all purposes of section 7874.

2. *Implication Regarding Scope of Public Offering Rule*

Section 1.7874–2T(e)(5), *Example 3*, involves a publicly traded foreign partnership that is treated as a surrogate foreign corporation under section 7874(a)(2)(B), but not as a domestic corporation under section 7874(b). In the example, the publicly traded foreign partnership acquires the stock of a domestic corporation in exchange for 75 percent of its outstanding interests. At the same time as the acquisition, an unrelated person acquires the remaining 25 percent interest in exchange for stock of a foreign corporation. The example concludes that the former shareholders of the domestic corporation hold 75 percent of the interests in the publicly traded foreign partnership by reason of holding stock of the domestic corporation. Implicit in this conclusion is that the 25 percent interest received by the unrelated person in exchange for the stock of the foreign corporation is not subject to the public offering rule of section 7874(c)(2)(B).

The IRS and the Treasury Department did not intend for this example to address the scope or application of the public offering rule of section 7874(c)(2)(B). The temporary regulations modify the example to eliminate the implication. The IRS and the Treasury Department are considering issuing guidance concerning the public offering rule of section 7874(c)(2)(B). Comments are requested in this regard.

H. *Options and Similar Interests*

The 2006 temporary regulations provide that, for purposes of section 7874(a)(2)(B)(ii), options and interests that are similar to options held by reason of holding stock in a domestic corporation (or an interest in a domestic partnership) shall be treated as exercised. Not addressed by the 2006 temporary regulations, however, is the treatment of options (or similar interests) or stock in a foreign corporation held by reason of holding options (or similar interests) in a domestic corporation (or a partnership, domestic or foreign). This issue may arise, for example, if the holder of a warrant to acquire stock of the domestic corporation exchanges the warrant for a warrant to acquire stock of the foreign acquiring corporation. The 2006 regulations also do not address the treatment of

options (or similar interests) in a foreign corporation not held by reason of holding stock in a domestic corporation (or an interest in a domestic partnership). Further, the IRS and the Treasury Department believe that treating options (or similar interests) as exercised may, in certain cases, lead to inappropriate results. For example, treating options (or similar interests) as exercised may distort the ownership of the foreign corporation for purposes of section 7874(a)(2)(B)(ii). For these reasons, the temporary regulations make the following changes to the rule provided by the 2006 temporary regulations.

1. *Domestic Corporations (or Partnerships)*

An option (or similar interest) represents a claim on equity to the extent the value of the stock (or partnership interest) that may be acquired pursuant to the option (or similar interest) exceeds the exercise price under the terms of the option (or similar interest). As a result, the temporary regulations provide that, for purposes of section 7874, an option (or similar interest) in a domestic corporation (or a partnership, domestic or foreign) shall be treated as stock of the domestic corporation (or an interest in the partnership) with a value equal to the holder's claim on the equity of the domestic corporation (or partnership) immediately before the acquisition described in section 7874(a)(2)(B)(i). For this purpose, the equity of the domestic corporation (or partnership) shall not include the value of any property the holder of the option (or similar interest) would be required to provide to the domestic corporation (or partnership) pursuant to the terms of the option (or similar interest) if such option (or similar interest) were exercised. Pursuant to these rules, for example, if the holder of an option in a domestic corporation receives stock of a foreign corporation by reason of holding the option, the holder shall be treated as holding the stock of the foreign corporation by reason of holding stock in the domestic corporation.

2. *Foreign Corporations*

The temporary regulations further provide that an option (or similar interest) in a foreign corporation shall generally be treated as stock of the foreign corporation with a value equal to the holder's claim on the equity of the foreign corporation immediately after the acquisition described in section 7874(a)(2)(B)(i). As is the case for options (and similar interests) with respect to domestic corporations (or partnerships), for this purpose the equity of the foreign corporation shall not include the value of any property the holder of the option (or similar interest) would be required to provide to the foreign corporation pursuant to the terms of the option (or similar interest) if such option (or similar interest) were exercised. This rule shall not apply, however, if a principal purpose of the issuance or acquisition of an option (or similar interest) is to avoid the foreign corporation being treated as a surrogate foreign corporation.

3. *Multiple Claims on Equity*

The rules of the temporary regulations concerning options (or similar interests) shall not apply to the extent treating an option (or similar interest) as stock of a corporation (or an interest in a partnership) would duplicate, in whole or in part, a shareholder's (or partner's) claim on the equity of the corporation (or partnership). However, except to the extent otherwise provided in section 7874, stock of a corporation held by a shareholder, or an interest in a partnership held by a partner, shall in all cases be taken into account for purposes of section 7874.

4. *Comments*

The IRS and the Treasury Department request comments on the rules provided by the temporary regulations concerning options (or similar interests). For example, comments are requested as to whether the rules should not apply to certain options, such as publicly traded options or compensatory options. Comments are also requested on the general approach of the rules, which treats the option (or similar interest) as stock or a partnership interest to the extent of the holder's claim on equity, as compared to an approach that would deem the options (or similar interests) as exercised. Any comments should consider the potential impact of treating options (or similar interests) as exercised on the determination of ownership in the foreign corporation under section 7874(a)(2)(B)(ii).

I. *Economically Equivalent Interests*

The IRS and the Treasury Department have become aware of transactions intended to avoid section 7874 by using interests (such as stock or partnership interests) that, although not in form exchangeable or convertible into stock of a foreign corporation, are structured to be substantially equivalent to an equity interest in the foreign corporation. In one such transaction, for example, a privately held domestic corporation (UST) intends to make an initial public offering of its stock for cash. The UST shareholders, however, would prefer a foreign corporation to be the publicly-traded corporation.

To accomplish these objectives the following transactions are completed. A newly formed foreign corporation (FC) issues shares to the public in exchange for cash and then contributes all or part of the cash to a newly-formed domestic corporation (S) in exchange for all the stock of S. S then merges with and into UST. Pursuant to the merger agreement, the UST shareholders exchange their UST stock for a new class of UST stock (class B stock) and cash. FC exchanges its S stock for all of the remaining class of stock of UST (class A stock). FC holds few assets other than the class A stock.

The class B stock entitles the UST shareholders to dividend distributions approximately equal to any dividend distributions made by FC with respect to its publicly traded stock. The class B stock also permits the UST shareholders, in certain cases, to require UST to redeem the class B stock at fair market value. The class B stock does not provide the holder voting rights with respect to FC.

Because FC holds few assets other than the class A stock of UST, the value of the class B stock held by the former UST shareholders is approximately equal to the value of a corresponding amount of FC stock. Further, the distribution and liquidity rights provided by the class B stock are intended to place the former UST shareholders in the same approximate economic position as if they had received publicly traded FC stock instead of the class B stock in the merger. Nonetheless, the former UST shareholders may take the position that they hold UST stock (and not FC stock) by reason of holding, in form, stock in UST and that the 2006 temporary reg-

ulations do not treat the class B stock as FC stock. For example, the former UST shareholders may take the position that the class B stock is not, in substance, an instrument other than debt that is convertible into stock of FC. See §1.7874–2T(f)(2). The former UST shareholders may further take the position that section 7874(c)(4) does not apply to the transaction. If these positions are correct, FC would not be treated as a surrogate foreign corporation. The IRS and the Treasury Department understand that similar transactions may be structured using a partnership.

The IRS and the Treasury Department believe these transactions are contrary to the policies underlying section 7874. Therefore, the temporary regulations provide that, for purposes of section 7874, any interest (including stock or a partnership interest) that is not otherwise treated as stock of a foreign corporation (including under the rules concerning options (or similar interests)) shall be treated as stock of the foreign corporation if the following two conditions are satisfied: (1) the interest entitles the holder to distribution rights that are substantially similar in all material respects to the distribution rights entitled to a shareholder of the foreign corporation by reason of holding stock in the foreign corporation; and (2) treating the interest as stock of the foreign corporation has the effect of treating the foreign corporation as a surrogate foreign corporation. For purposes of the first condition, distribution rights include rights to dividend distributions (or partnership distributions), distributions in redemption of the interest (in whole or in part), distributions in liquidation, or other similar distributions that represent a return on, or of, the holder's investment in the interest.

J. *Insolvent Entities*

The preamble to the 2008 final regulations describes a transaction involving an insolvent domestic corporation in which the creditors of the corporation claim not to be shareholders of the corporation for purposes of determining whether a foreign corporation that acquires substantially all of the properties held by the domestic corporation is treated as a surrogate foreign corporation. As further stated in the preamble, the IRS and the Treasury Department disagree with this interpretation under current law. See, for example, *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U.S. 179 (1942), and §1.368–1(e)(6).

The temporary regulations clarify that, for purposes of section 7874, if immediately prior to the first date properties are acquired as part of an acquisition described in section 7874(a)(2)(B)(i), a domestic corporation is in a title 11 or similar case (as defined in section 368(a)(3)), or the liabilities of the domestic corporation exceed the value of its assets, then any claim by a creditor against the domestic corporation shall be treated as stock of the domestic corporation. Therefore, any stock of a foreign corporation held by a creditor of the domestic corporation by reason of its claim against the domestic corporation would be considered held by a former shareholder of the domestic corporation by reason of holding stock in the domestic corporation.

A similar rule applies with respect to a domestic or foreign partnership. Foreign partnerships are included in this rule because, for purposes of section 7874(a)(2)(B)(ii), the acquisition of an interest in a foreign partnership that owns stock of a domestic corporation is considered an acquisition of a proportionate amount of the stock of domestic corporation. Therefore, if a foreign corporation acquired a sufficient interest in that foreign partnership, the foreign corporation could be treated as a surrogate foreign corporation.

One commentator requested the regulations clarifying the treatment of creditors for purposes of section 7874 make clear that a creditor that is treated as a shareholder of a domestic corporation is treated as a shareholder for all purposes of section 7874. In particular, the commentator requested the regulations make clear that the provisions of the 2008 final regulations concerning the determination of the stock of a foreign corporation held by reason of holding stock of the domestic corporation apply equally to such a creditor. The IRS and the Treasury Department agree with this comment. Accordingly, the temporary regulations clarify that a creditor that is treated as a shareholder of a domestic corporation (or as a partner in a partnership) is treated as a shareholder (or partner) for all purposes of section 7874. Thus, for example, subject to section 7874(c)(4) and general tax principles, stock of the foreign corporation received by a creditor in exchange for other property would not be taken into account in determining former shareholder (or former partner) ownership under section 7874(a)(2)(B)(ii).

K. *Modification to Internal Restructuring Exception of 2008 Final Regulations*

The IRS and the Treasury Department have become aware of divisive transactions involving an acquisition described in section 7874(a)(2)(B)(i) in which the ownership condition of section 7874(a)(2)(B)(ii) may not be satisfied by reason of the internal group restructuring exception provided by §1.7874–1(c)(2). For example, assume that a publicly-traded domestic corporation (USP) wholly owns a domestic subsidiary (S1) that in turn wholly owns another domestic subsidiary (S2). The S2 stock does not represent substantially all of the properties of S1. Pursuant to a plan, S2 transfers substantially all of its properties to a newly formed foreign corporation (F1) in exchange for F1 stock and then distributes the F1 stock to S1. Pursuant to the same plan, S1 distributes the F1 stock to USP, and USP then distributes the F1 stock to its shareholders.

The acquisition by F1 of substantially all of the properties held by S2 is described in section 7874(a)(2)(B)(i). In addition, S1, the former shareholder of S2, holds all the F1 stock by reason of holding S2 stock. However, taxpayer may take the position that the condition of section 7874(a)(2)(B)(ii) is not satisfied by reason of the internal group restructuring exception under §1.7874–1(c)(2). In relevant part, the internal group restructuring exception provides that, for purposes of section 7874(a)(2)(B)(ii), stock of the foreign corporation held by a member of the expanded affiliated group shall be included in the denominator, but not in the numerator, of the ownership fraction, if: (i) before the acquisition, at least 80 percent of the stock (by vote and value) of the domestic corporation was held directly or indirectly by the corporation that is the common parent of the expanded affiliated group after the acquisition; and (ii) after the acquisition, at least 80 percent of the stock (by vote and value) of the acquiring foreign corporation is held directly or indirectly by such common parent.

Taxpayer may take the position that the internal restructuring exception applies because before the acquisition USP indirectly owned 100 percent of the stock of S2 and after the acquisition USP indirectly owned 100 percent of the stock of F1. Therefore, the F1 stock held by S1 would be included in the denominator but not the numerator of the ownership fraction, yielding zero percent former shareholder ownership and resulting in F1 not being treated as a surrogate foreign corporation.

The IRS and the Treasury Department believe it is inappropriate for the internal restructuring exception to apply to divisive transactions such as the one described above. Accordingly, the IRS and the Treasury Department will issue regulations that determine former shareholder ownership under section 7874(a)(2)(B)(ii) when pursuant to the same plan (or a series of related transactions) that includes the acquisition described in section 7874(a)(2)(B)(i), all or part of the stock of the foreign corporation is transferred outside the expanded affiliated group that includes the foreign corporation after the acquisition. The regulations will provide that the internal group restructuring exception of §1.7874–1(c)(2) does not apply to such transactions and will also modify the application of the general rule of §1.7874–1(b) to such transactions. The regulations may apply to acquisitions completed on or after June 9, 2009.

L. *Effective/Applicability Dates*

The temporary regulations included in this document generally apply to acquisitions completed on or after June 9, 2009. However, taxpayers may apply the temporary regulations to acquisitions completed prior to June 9, 2009, if the temporary regulations are applied consistently to all acquisitions completed prior to such date.

The temporary regulations include the modifications announced by Notice 2006–70, 2006–2 C.B. 252, to the effective date paragraph of §1.7874–2T, as contained in 26 CFR part 1 revised as of April 1, 2009, for certain acquisitions initiated prior to December 28, 2005.

No inference is intended as to the applicability of other Code or regulatory provisions, or judicial doctrines, to any transactions described in this preamble.

These regulations will expire on or before June 8, 2012.

Effect on Other Documents

Notice 2006–70, 2006–2 C.B. 252, is obsolete as of June 9, 2009.

Special Analyses

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

The temporary regulations do not impose a collection of information. Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is also hereby certified that the temporary regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. The complexity and cost of a transaction to which section 7874 may apply makes it unlikely that a substantial number of small entities will engage in such a transaction. In addition, the economic impact to any entities affected by section 7874 is derived from the application of the statute, and not from the temporary regulations. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business.

Drafting Information

The principal author of the temporary regulations is S. James Hawes, Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

Authority: 26 USC 7805 * * *

Section 1.7874–1T also issued under 26 U.S.C. 7874(g). * * *

Section 1.7874–2T also issued under 26 U.S.C. 7874(c)(6) and (g). * * *

Par. 2. Section 1.7874–1(e) is revised to read as follows:

§1.7874–1 Disregard of affiliate-owned stock.

* * * * *

(e) [Reserved]. For further guidance, see §1.7874–1T(e).

* * * * *

Par. 3. Section 1.7874–1T is added to read as follows:

§1.7874–1T Disregard of affiliate-owned stock (temporary).

(a) through (d) [Reserved]. For further guidance, see §1.7874–1(a) through (d).

(e) *Stock held by a partnership*. For purposes of this section, each partner in a partnership shall be treated as holding its proportionate share of stock held by the partnership, as determined under the rules and principles of sections 701 through 777.

(f) [Reserved]. For further guidance, see §1.7874–1(f).

(g) *Effective/applicability date*. Paragraph (e) of this section shall apply to acquisitions completed on or after June 9, 2009. See §1.7874–1(e), as contained in 26 CFR part 1 revised as of April 1, 2009, for transactions completed before June 9, 2009.

(h) *Expiration date*. The applicability of this section expires on or before June 8, 2012.

Par. 4. Section 1.7874–2T is revised to read as follows:

§1.7874–2T Surrogate foreign corporation (temporary).

(a) *Scope*. This section provides rules for determining whether a foreign corporation shall be treated as a surrogate foreign corporation under section 7874(a)(2)(B). Paragraph (b) of this section provides definitions and special rules. Paragraph (c) of this section provides rules to determine whether a foreign corporation has indirectly acquired properties held by a domestic corporation (or of a partnership). Paragraph (d) of this section provides rules that apply when two or more foreign corporations complete, in

the aggregate, an acquisition described in section 7874(a)(2)(B)(i). Paragraph (e) of this section provides rules that apply when a single foreign corporation completes more than one acquisition described in section 7874(a)(2)(B)(i). Paragraph (f) of this section provides rules to identify the stock of a foreign corporation that is held by reason of holding stock in a domestic corporation (or an interest in a domestic partnership). Paragraph (g) of this section provides rules concerning the substantial business activities condition of section 7874(a)(2)(B)(iii). Paragraph (h) of this section provides rules that treat certain publicly traded foreign partnerships as foreign corporations for purposes of section 7874. Paragraph (i) of this section is reserved. Paragraph (j) of this section provides rules concerning the treatment of certain options (or similar interests) for purposes of section 7874. Paragraph (k) of this section provides rules that treat certain interests (including debt, stock, or a partnership interest) as stock of a foreign corporation for purposes of section 7874. Paragraph (l) of this section is reserved. Paragraph (m) of this section provides rules concerning the conversion of a foreign corporation to a domestic corporation by reason of section 7874(b). Paragraph (n) of this section provides examples that illustrate the rules of this section. Paragraph (o) of this section provides the effective/applicability dates of this section. Paragraph (p) of this section provides the expiration date of this section.

(b) *Definitions and special rules*. Except as otherwise indicated, the following definitions and special rules apply for purposes of this section.

(1) The rules of this section are subject to section 7874(c)(4).

(2) An *interest* in a partnership includes a capital or profits interest.

(3) A *former shareholder* of a domestic corporation is any person that held stock in the domestic corporation before the acquisition described in section 7874(a)(2)(B)(i), including any person that holds stock in the domestic corporation both before and after the acquisition.

(4) A *former partner* of a domestic partnership is any person that held an interest in the domestic partnership before the acquisition described in section 7874(a)(2)(B)(i), including any person that holds an interest in the domestic partnership both before and after the acquisition.

(5) References to *properties held* by a domestic corporation include properties held directly or indirectly by the domestic corporation.

(6) The rules and principles of sections 701 through 777 shall be applied for purposes of determining a proportionate amount (or share) of items of a partnership (such as stock, properties, activities and employees).

(7) Any reference to the acquisition of properties held by a domestic corporation (or of a partnership) includes a direct or indirect acquisition of such properties.

(8) In the case of an acquisition of stock of a domestic corporation or an interest in a partnership, the proportionate amount of properties held by the domestic corporation (or of the partnership) that is treated as indirectly acquired shall, as applicable, be determined on the date of the acquisition based on the relative value of—

(i) The stock acquired compared to all outstanding stock of the domestic corporation; or

(ii) The interest acquired compared to all interests in the partnership.

(9) The determination of whether a foreign corporation is a surrogate foreign corporation is made after the acquisition described in section 7874(a)(2)(B)(i). A foreign corporation that is treated as a surrogate foreign corporation (including a surrogate foreign corporation treated as a domestic corporation described in section 7874(b)) shall continue to be treated as a surrogate foreign corporation (or a domestic corporation), even if the conditions of section 7874(a)(2)(B)(ii) and (iii) are not satisfied at a later date.

(c) *Acquisition of properties*—(1) *Indirect acquisition of properties*. For purposes of section 7874(a)(2)(B)(i), an indirect acquisition of properties held by a domestic corporation (or of a partnership) includes the acquisitions described in paragraphs (c)(1)(i) through (iv) of this section. An acquisition of less than all of the stock of a domestic corporation (or interests in a partnership) shall constitute an indirect acquisition of a proportionate amount of the properties held by the domestic corporation or of the partnership. See paragraph (b)(8) of this section for rules determining the proportionate amount of properties indirectly acquired.

(i) An acquisition of stock of a domestic corporation. See *Example 1* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(ii) An acquisition of an interest in a partnership. See *Example 2* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(iii) An acquisition by a corporation (acquiring corporation) of properties held by a domestic corporation (or of a partnership) in exchange for stock of a foreign corporation (foreign issuing corporation) that is part of the expanded affiliated group that includes the acquiring corporation after the acquisition shall be treated as an acquisition by the foreign issuing corporation. See *Example 3* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(iv) An acquisition by a partnership (acquiring partnership) of properties held by a domestic corporation (or of a partnership) in exchange for stock of a foreign corporation that is part of the expanded affiliated group that would include the acquiring partnership after the acquisition (if the partnership were a corporation) shall be treated as an acquisition by the foreign issuing corporation.

(2) *Acquisition of stock of foreign corporation*. An acquisition of stock of a foreign corporation that owns directly or indirectly stock of a domestic corporation (or an interest in a partnership) shall not constitute an indirect acquisition of any properties held by the domestic corporation (or the partnership). See *Example 4* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(d) *Acquisitions by multiple foreign corporations*. If, pursuant to a plan (or a series of related transactions), two or more foreign corporations complete, in the aggregate, an acquisition described in section 7874(a)(2)(B)(i), then each foreign corporation shall be treated as completing the acquisition for purposes of determining whether such foreign corporation is treated as a surrogate foreign corporation. See *Examples 5* and *6* of paragraph (n) of this section for illustrations of the rules of this paragraph.

(e) *Acquisitions of multiple domestic entities*. If, pursuant to a plan (or a series of related transactions), a foreign corporation completes two or more acquisitions described in section 7874(a)(2)(B)(i) involv-

ing domestic corporations and/or domestic partnerships (domestic entities), then, for purposes of section 7874(a)(2)(B)(ii), the acquisitions shall be treated as a single acquisition and the domestic entities shall be treated as a single domestic entity. If the transaction involves one or more domestic corporations and one or more domestic partnerships, the stock of the foreign corporation held by former shareholders and former partners by reason of holding stock or a partnership interest in the domestic entities shall be aggregated for purposes of determining whether the ownership condition of section 7874(a)(2)(B)(ii) is satisfied. See *Example 7* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(f) *Stock held by reason of holding stock in a domestic corporation or an interest in a domestic partnership*—(1) *Specified transactions*. For purposes of section 7874(a)(2)(B)(ii), stock of a foreign corporation that is held by reason of holding stock in a domestic corporation (or an interest in a domestic partnership) includes the stock described in paragraphs (f)(1)(i) through (iii) of this section.

(i) Stock of a foreign corporation received in exchange for, or with respect to, stock of a domestic corporation.

(ii) Stock of a foreign corporation received in exchange for, or with respect to, an interest in a domestic partnership.

(iii) To the extent that paragraph (f)(1)(ii) of this section does not apply, stock of a foreign corporation received by a domestic partnership in exchange for all or part of its properties. In such a case, each partner in the domestic partnership shall be treated as holding its proportionate share of the stock of the foreign corporation by reason of holding an interest in the domestic partnership.

(2) *Transactions involving other property*—(i) *Stock of a domestic corporation*. If, pursuant to the same transaction, stock of a foreign corporation is received in exchange for, or with respect to, stock of a domestic corporation and other property, the stock of the foreign corporation that was received in exchange for, or with respect to, the stock of the domestic corporation shall be determined based on the relative value of the stock of the domestic corporation compared to the aggregate value of such stock and the other property.

(ii) *Interest in a domestic partnership*. If, pursuant to the same transaction, stock of a foreign corporation is received in exchange for, or with respect to, an interest in a domestic partnership and other property, the stock of the foreign corporation that was received in exchange for, or with respect to, the interest in the domestic partnership shall be determined based on the relative value of the interest in the domestic partnership compared to the aggregate value of such interest and the other property.

(3) See *Examples 8* through *10* of paragraph (n) of this section for illustrations of the rules of this paragraph (f).

(g) *Substantial business activities*—(1) *General rule*. The determination of whether, after the acquisition, the expanded affiliated group that includes the foreign corporation has substantial business activities in the foreign country in which, or under the law of which, the foreign corporation is created or organized when compared to the total business activities of the expanded affiliated group, is (subject to paragraph (g)(5) of this section) based on all facts and circumstances.

(2) *Threshold of business activities*. The determination of whether the expanded affiliated group has sufficient business activities in a foreign country is not solely based on the absolute amount of business activities in the foreign country. Rather the determination is based on a comparison of the amount of business activities in the foreign country to the total business activities of the expanded affiliated group. The determination must take into account the total business activities of the expanded affiliated group, including the relevant items identified in paragraph (g)(3) of this section. Thus, it is possible for the business activities of one expanded affiliated group in a particular country to be substantial when compared to the total business activities of such expanded affiliated group, but for identical business activities of another expanded affiliated group in the same country not to be substantial when compared to the total business activities of that other expanded affiliated group. This may result, for example, because the total business activities of the second expanded affiliated group are more extensive than that of the first expanded affiliated group.

(3) *Items to be considered*. Except as provided in paragraph (g)(5) of this section, relevant items to be considered for determining whether, after the acquisition, the expanded affiliated group has substantial business activities in a foreign country when compared to the total business activities of the expanded affiliated group include the items identified in paragraphs (g)(3)(i) through (v) of this section. The presence or absence of any item, or set of items, is not determinative and the weight given to any item, or set of items, depends on the facts and circumstances.

(i) The historical conduct of continuous business activities in the foreign country by the expanded affiliated group.

(ii) The conduct of continuous business activities in the foreign country by the expanded affiliated group in the ordinary course of one or more active trades or businesses, involving—

(A) Property located in the foreign country that is owned by members of the expanded affiliated group;

(B) The performance of services in the foreign country by employees of the expanded affiliated group; and

(C) Sales of goods to customers.

(iii) The performance in the foreign country of substantial managerial activities by officers and employees of the expanded affiliated group who are based in the foreign country.

(iv) A substantial degree of ownership of the expanded affiliated group by investors resident in the foreign country.

(v) Business activities in the foreign country that are material to the achievement of the overall business objectives of the expanded affiliated group.

(4) *Attribution from a partnership*. For purposes of this paragraph (g), a member of the expanded affiliated group that holds at least a 10 percent capital and profits interest in a partnership shall take into account its proportionate share of all the items of the partnership, including business activities, employees, assets, income and sales. See paragraph (b)(6) of this section for determining a partner's proportionate share of the items of a partnership.

(5) *Items not to be considered*. The following items shall not be taken into account in determining whether, after the acquisition, the expanded affiliated group has substantial business activities in a foreign country when compared to the total

business activities of the expanded affiliated group.

(i) Any business activities or income attributable to properties or liabilities the transfer of which is disregarded under section 7874(c)(4).

(ii) Any assets, business activities, or employees located in a foreign country at any time as part of a plan with a principal purpose of avoiding the purposes of section 7874.

(iii) Any assets, business activities, or employees located in the foreign country in which, or under the law of which, the foreign corporation is created or organized if such assets, business activities or employees are transferred to another country pursuant to a plan that existed at the time of the acquisition described in section 7874(a)(2)(B)(i).

(h) *Publicly traded foreign partnerships*—(1) *Treatment as a foreign corporation*. For purposes of section 7874, a publicly traded foreign partnership described in paragraph (h)(2) of this section shall be treated as a foreign corporation that is organized in the foreign country in which, or under the law of which, the publicly traded foreign partnership was created or organized, and interests in the publicly traded foreign partnership shall be treated as stock of the foreign corporation. For purposes of determining whether the foreign corporation shall be treated as a surrogate foreign corporation, a deemed acquisition of assets and liabilities by reason of §1.708–1(b)(4) shall not constitute an acquisition described in section 7874(a)(2)(B)(i).

(2) *Publicly traded foreign partnership*. A publicly traded foreign partnership described in this paragraph (h)(2) is any foreign partnership that would, but for section 7704(c), be treated as a corporation under section 7704(a):

(i) At the time of the acquisition described in section 7874(a)(2)(B)(i); or

(ii) At any time after the acquisition pursuant to a plan that existed at the time of the acquisition. For this purpose, a plan shall be deemed to exist at the time of the acquisition if the foreign partnership would, but for section 7704(c), be treated as a corporation under section 7704(a) at any time during the two-year period following the completion of the acquisition.

(3) *Surrogate foreign corporation to which section 7874(b) applies*. If paragraph (h)(1) of this section applies to a publicly traded foreign partnership and the foreign corporation is a surrogate foreign corporation to which section 7874(b) applies, the publicly traded foreign partnership shall be treated as a domestic corporation for purposes of the Internal Revenue Code (Code). See paragraph (h)(6) of this section for the timing and treatment of the conversion of the publicly traded foreign partnership to a domestic corporation. See *Example 11* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(4) *Surrogate foreign corporation to which section 7874(b) does not apply*. If paragraph (h)(1) of this section applies to a publicly traded foreign partnership and the foreign corporation is a surrogate foreign corporation to which section 7874(b) does not apply, the publicly traded foreign partnership shall continue to be treated as a foreign partnership for purposes of the Code, but section 7874(a)(1) shall apply to any expatriated entity (as defined in section 7874(a)(2)(A)). See *Example 13* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(5) *Foreign corporation not treated as a surrogate foreign corporation*. If paragraph (h)(1) of this section applies to a publicly traded foreign partnership and the foreign corporation is not treated as a surrogate foreign corporation, the status of the publicly traded foreign partnership as a foreign partnership shall not be affected by section 7874. See *Example 12* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(6) *Conversion to a domestic corporation*. Except for purposes of determining whether the publicly traded foreign partnership is a surrogate foreign corporation, if paragraph (h)(1) of this section applies to a publicly traded foreign partnership and the foreign corporation is a surrogate foreign corporation to which section 7874(b) applies, then immediately before the first date properties are acquired as part of the acquisition described in section 7874(a)(2)(B)(i) the publicly traded foreign partnership shall be treated as transferring all of its assets and liabilities to a newly formed domestic corporation in exchange solely for stock of the domestic corporation, and then distributing such stock to its partners in proportion to their partnership interests in liquidation of the partnership. The treatment of the transfer of assets and liabilities to the domestic corporation and the distribution of the stock of the domestic corporation to the partners in liquidation of the partnership shall be determined under all relevant provisions of the Code and general tax principles.

(i) [Reserved].

(j) *Options and similar interests*—(1) *Domestic corporation (or partnership)*. Except to the extent provided in this paragraph (j), for purposes of section 7874, an option (or similar interest) with respect to a domestic corporation (or a partnership, domestic or foreign) shall be treated as stock of the domestic corporation (or an interest in the partnership) with a value equal to the holder's claim on the equity of the domestic corporation (or partnership) immediately before the acquisition described in section 7874(a)(2)(B)(i). For this purpose, the equity of the domestic corporation (or partnership) shall not include the amount of any property the holder of the option (or similar interest) would be required to provide to the domestic corporation (or partnership) under the terms of the option (or similar interest) if such option (or similar interest) were exercised. See *Example 16* of paragraph (n) of this section for an illustration of the rules of this paragraph.

(2) *Foreign corporation*—(i) *General rule*. Except to the extent provided in this paragraph (j), for purposes of section 7874 an option (or similar interest) with respect to a foreign corporation shall be treated as stock of the foreign corporation with a value equal to the holder's claim on the equity of the foreign corporation after the acquisition described in section 7874(a)(2)(B)(i). For this purpose, the equity of the foreign corporation shall not include the amount of any property the holder of the option (or similar interest) would be required to provide to the foreign corporation under the terms of the option (or similar interest) if such option (or similar interest) were exercised. See *Examples 14* through *16* of paragraph (n) of this section for illustrations of the rules of this paragraph (j)(2)(i).

(ii) *Certain options (or similar interests) disregarded*. Paragraph (j)(2)(i) of this section shall not apply to an option (or similar interest) if a principal purpose of the issuance or acquisition of the option (or similar interest) is to avoid the foreign cor-

poration being treated as a surrogate foreign corporation.

(3) *Similar interest*. For purposes of this paragraph (j), an interest similar to an option (a similar interest) includes, but is not limited to, a warrant, a convertible debt instrument, an instrument other than debt that is convertible into stock or a partnership interest, a put, stock or a partnership interest subject to risk of forfeiture, a contract to acquire or sell stock or a partnership interest, and an exchangeable share or exchangeable partnership interest.

(4) *Multiple claims on equity*. Paragraphs (j)(1) and (j)(2)(i) of this section shall not apply to an option (or similar interest) to the extent treating the option (or similar interest) as stock of a corporation (or interest in a partnership) would duplicate a shareholder's (or partner's) claim on the equity of the corporation (or partnership) by reason of holding stock in the corporation (or an interest in the partnership). However, except to the extent otherwise provided in section 7874, in all cases stock of a corporation held by a shareholder or an interest in a partnership held by a partner (without regard to this paragraph (j)) shall be taken into account for purposes of section 7874. See *Example 15* of paragraph (n) of this section for an illustration of the rules of this paragraph (j)(4).

(k) *Interests treated as stock of a foreign corporation*—(1) *Stock or other interests*. If the conditions of paragraphs (k)(1)(i) and (ii) of this section are satisfied, then, for purposes of section 7874, any interest (including stock or a partnership interest) that is not otherwise treated as stock of a foreign corporation (including under paragraph (j)(2)(i) of this section) shall be treated as stock of the foreign corporation. See *Examples 17* and *18* of paragraph (n) of this section for illustrations of the rules of this paragraph (k)(1).

(i) The interest provides the holder distribution rights that are substantially similar in all material respects to the distribution rights provided by stock in the foreign corporation. For this purpose, distribution rights include rights to dividends (or partnership distributions), distributions in redemption of the interest (in whole or in part), distributions in liquidation, or other similar distributions that represent a return on, or of, the holder's investment in the interest.

(ii) Treating the interest as stock of the foreign corporation has the effect of treating the foreign corporation as a surrogate foreign corporation.

(2) *Creditor claims*—(i) *Domestic corporation*. For purposes of section 7874, if, immediately prior to the first date properties are acquired as part of an acquisition described in section 7874(a)(2)(B)(i), a domestic corporation is in a title 11 or similar case (as defined in section 368(a)(3)), or the liabilities of the domestic corporation exceed the value of its assets, then each creditor of the domestic corporation shall be treated as a shareholder of the domestic corporation and any claim of the creditor against the domestic corporation shall be treated as stock of the domestic corporation. See *Example 19* of paragraph (n) of this section for an illustration of the rules of this paragraph (k)(2)(i).

(ii) *Domestic or foreign partnership*. For purposes of section 7874, if, immediately prior to the first date properties are acquired as part of an acquisition described in section 7874(a)(2)(B)(i), a partnership (foreign or domestic) is in a title 11 or similar case (as defined in section 368(a)(3)), or the liabilities of the partnership exceed the value of its assets, then each creditor of the partnership shall be treated as a partner in the partnership and any claim of the creditor against the partnership shall be treated as an interest in the partnership.

(iii) *Treatment of creditor as shareholder or partner*. A creditor that is treated as a shareholder or partner under paragraph (k)(2)(i) or (ii) of this section shall be treated as a shareholder or partner for all purposes of section 7874. See, for example, §1.7874–1(c) and paragraph (f) of this section. See *Example 19* of paragraph (n) of this section for an illustration of the rules of this paragraph (k)(2)(iii).

(l) [Reserved].

(m) *Application of section 7874(b)*—(1) *Conversion to a domestic corporation*. Except for purposes of determining whether a foreign corporation is treated as a surrogate foreign corporation, the conversion of a foreign corporation to a domestic corporation by reason of section 7874(b) shall constitute a reorganization described in section 368(a)(1)(F) that occurs immediately before the first date properties are acquired as part of the acquisition described in section 7874(a)(2)(B)(i). See, for example, §§1.367(b)–2 and 1.367(b)–3 for certain consequences of the reorganization. The treatment of all other aspects of the conversion shall be determined under the relevant provisions of the Code and general tax principles. See *Example 20* of paragraph (n) of this section for an illustration of the rules of this paragraph (m)(1).

(2) *Entity classification*. A foreign corporation that is treated as a domestic corporation under section 7874(b) is not an eligible entity as defined in §301.7701–3(a) of this chapter and therefore may not elect to be treated as other than an association for Federal tax purposes.

(3) *Application of section 367*. If a foreign corporation is treated as a domestic corporation under section 7874(b), section 367 shall not apply to any transfer of property by a United States person to such foreign corporation as part of the acquisition described in section 7874(a)(2)(B)(i). However, section 367 shall apply to the conversion of the foreign corporation to a domestic corporation. See paragraph (m)(1) of this section. See *Example 20* of paragraph (n) of this section for an illustration of the rules of this paragraph (m)(3).

(n) *Examples*—(1) *Assumed facts*. Except as otherwise stated, assume the following for purposes of the examples included in paragraph (n)(2) of this section.

(i) DC1 and DC2 are domestic corporations.

(ii) FA, FP, F1, F2, F3, and F4 are foreign corporations organized in Country A.

(iii) DPS is a domestic partnership that conducts a trade or business.

(iv) FPS is a foreign partnership that is not publicly traded.

(v) A, B, and C are unrelated individuals.

(vi) Each entity has a single class of equity outstanding and is unrelated to all other entities.

(vii) All transactions are completed pursuant to a plan.

(viii) All acquisitions of properties are completed after March 4, 2003.

(ix) Neither section 7874(c)(4) nor paragraph (j)(2)(ii) of this section applies.

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

Example 1. Acquisition of stock of a domestic corporation. (i) *Facts.* FA acquires 25 percent of the outstanding stock of DC1.

(ii) *Analysis*. Under paragraph (c)(1)(i) of this section, for purposes of section 7874(a)(2)(B)(i) FA is treated as acquiring 25 percent of the properties held by DC1 on the date of the stock acquisition.

Example 2. Acquisition of a partnership interest. (i) *Facts*. DPS wholly owns DC1. FA acquires a 40 percent interest in DPS.

(ii) *Analysis*. Under paragraph (c)(1)(ii) of this section, for purposes of section 7874(a)(2)(B)(i) FA is treated as acquiring 40 percent of the DC1 stock held by DPS on the date of the acquisition of the partnership interest. Further, under paragraph (c)(1)(i) of this section, for purposes of section 7874(a)(2)(B)(i) FA is treated as acquiring 40 percent of the properties held by DC1 on the date of the acquisition of the partnership interest.

Example 3. Acquisition of stock by a subsidiary. (i) *Facts*. FP wholly owns FA. FA acquires all the outstanding stock of DC1 in exchange solely for FP stock. FP and FA are members of the same expanded affiliated group after the acquisition.

(ii) *Analysis*. Under paragraph (c)(1)(i) of this section, for purposes of section 7874(a)(2)(B)(i) FA is treated as acquiring 100 percent of the properties held by DC1 on the date of the stock acquisition. Further, under paragraph (c)(1)(iii) of this section, for purposes of section 7874(a)(2)(B)(i) FP is also treated as acquiring 100 percent of the properties held by DC1 on the date of the stock acquisition. The result would be the same if instead FA had directly acquired all the properties held by DC1 in exchange for FP stock.

Example 4. Acquisition of stock of a foreign corporation. (i) *Facts*. FP wholly owns DC1. FA acquires all of the outstanding stock of FP.

(ii) *Analysis*. Under paragraph (c)(2) of this section, for purposes of section 7874(a)(2)(B)(i) FA is not treated as acquiring any properties held by DC1 on the date of the acquisition of the FP stock.

Example 5. Acquisition of stock by multiple foreign corporations. (i) *Facts*. Pursuant to the same plan, the shareholders of DC1 transfer all of their DC1 stock equally to F1, F2, F3, and F4 in exchange solely for stock of each foreign corporation.

(ii) *Analysis*. Under paragraph (c)(1)(i) of this section, in the aggregate F1, F2, F3 and F4 are treated as acquiring substantially all of the properties held by DC1. Because the acquisition was pursuant to the same plan, under paragraph (d) of this section, F1, F2, F3, and F4 are each treated as acquiring substantially all of the properties held by DC1 for purposes of determining whether each foreign corporation shall be treated as a surrogate foreign corporation.

Example 6. Acquisition of assets by multiple foreign corporations. (i) *Facts*. Individual A wholly owns DC1. DC1 forms F1, F2, F3, and F4, and transfers an equal portion of its properties to each corporation in exchange solely for stock of the corporation. Pursuant to the same plan DC1 then distributes the stock of each foreign corporation to individual A.

(ii) *Analysis*. Because pursuant to the same plan F1, F2, F3 and F4 acquired, in the aggregate, substantially all of the properties held by DC1, under paragraph (d) of this section, F1, F2, F3, and F4 are each treated as acquiring substantially all of the properties held by DC1 for purposes of determining whether each foreign corporation shall be treated as a surrogate foreign corporation.

Example 7. Acquisition of multiple domestic corporations. (i) *Facts*. Individual A wholly owns DC1, and individual B wholly owns DC2. Pursuant to the same plan, A and B transfer all of their DC1 stock and DC2 stock to FA, a newly formed corporation, in exchange solely for all 100 shares of FA stock outstanding.

(ii) *Analysis*. Under paragraph (c)(1)(i) of this section, for purposes of section 7874(a)(2)(B)(i) FA is treated as acquiring all of the properties held by DC1 and DC2 on the date of the stock acquisition. Under paragraph (e) of this section, because pursuant to the same plan FA acquired substantially all of the properties held by DC1 and DC2, for purposes of determining whether FA shall be treated as a surrogate foreign corporation, DC1 and DC2 shall be treated as a single domestic corporation, of which A and B are former shareholders. Thus, individuals A and B are treated as holding all 100 shares of the FA stock by reason of holding stock of such domestic corporation, and the ownership fraction under section 7874(a)(2)(B)(ii) is 100/100, or 100 percent.

Example 8. Exchange of stock and other property. (i) *Facts*. Individual A wholly owns DC1 and F1. DC1 has a $40x value and F1 has a $60x value. Individual A transfers all of the DC1 stock and F1 stock to FA, a newly-formed corporation, in exchange solely for FA stock.

(ii) *Analysis*. Under paragraphs (f)(1)(i) and (f)(2)(i) of this section, for purposes of section 7874(a)(2)(B)(ii) individual A is considered to hold 40 percent of the FA stock by reason of holding stock in DC1 ($100x FA stock multiplied by $40x/$100x, the relative value of the DC1 stock to all the property transferred by A to FA).

Example 9. Stock received as a distribution. (i) *Facts*. Pursuant to a divisive reorganization described in section 368(a)(1)(D), DC1 contributes substantially all of its properties to FA, a newly-formed corporation, in exchange solely for FA stock and then distributes the FA stock to its shareholders under section 355.

(ii) *Analysis*. Under paragraph (f)(1)(i) of this section, for purposes of section 7874(a)(2)(B)(ii) the FA stock received by the DC1 shareholders as a distribution with respect to the DC1 stock is considered held by reason of holding stock in DC1. The result would be the same if the transaction did not qualify as a reorganization (for example, if the distribution were subject to sections 301 and 311(b)).

Example 10. Incorporation of a partnership trade or business. (i) *Facts*. Individuals A and B equally own DPS. DPS transfers substantially all of its properties constituting a trade or business to FA, a newly-formed corporation, solely in exchange for FA stock. DPS retains the FA stock after the transaction.

(ii) *Analysis*. Under paragraph (f)(1)(iii) of this section, for purposes of section 7874(a)(2)(B)(ii) individuals A and B are treated as holding a proportionate amount (that is, an equal amount) of the FA stock held by DPS by reason of holding an interest in DPS.

Example 11. Publicly traded foreign partnership treated as domestic corporation. (i) *Facts*. Pursuant to a plan, DC1 and individual B organize a limited liability company (HPS) under the law of Country A. DC1 owns 99.9 percent of the membership interests in HPS, and B owns 0.1 percent of the membership interests in HPS. HPS is a foreign eligible entity under §301.7701–2 of this chapter, and DC1 and B make an election under §301.7701–3 of this chapter to treat HPS as a partnership for Federal tax purposes as of the date of the formation of HPS. HPS forms DC2. DC2 merges with and into DC1. Pursuant to the merger agreement, the DC1 shareholders exchange their DC1 stock solely for membership interests in HPS. After the merger HPS wholly owns DC1, and the former shareholders of DC1 own a greater than 80 percent interest in HPS by reason of holding stock of DC1. Public trading of the HPS ownership interests begins the day after the date on which merger is completed. HPS is not treated as a corporation under section 7704(a) by reason of section 7704(c). If HPS were a corporation, the condition of section 7874(a)(2)(B)(iii) would be satisfied.

(ii) *Analysis*. HPS is a publicly traded foreign partnership that is described in paragraph (h)(2) of this section. Therefore, under paragraph (h)(1) of this section, for purposes of section 7874 HPS is treated as a foreign corporation organized under the law of Country A and the membership interests in HPS are treated as stock of the foreign corporation. The foreign corporation is treated as a surrogate foreign corporation under section 7874(a)(2)(B) because, pursuant to the merger, HPS acquired substantially all of the properties held by DC1, the former shareholders of DC1 hold at least 60 percent of the stock of the foreign corporation by reason of holding stock of DC1, and the expanded affiliated group that includes the foreign corporation does not have substantial business activities in Country A when compared to the total business activities of the expanded affiliated group. Further, because the former shareholders of DC1 hold at least 80 percent of the stock of the foreign corporation by reason of holding stock of DC1, section 7874(b) applies to the surrogate foreign corporation, and therefore HPS is treated as a domestic corporation for purposes of the Code. Under paragraph (h)(6) of this section, except for purposes of determining whether HPS is a surrogate foreign corporation, immediately before the merger of DC2 with and into DC1 HPS is treated as transferring all of its assets and liabilities to a new domestic corporation in exchange solely for stock of the domestic corporation. HPS is then treated as proportionately distributing such stock to its membership holders in liquidation of the partnership. In addition, as a result of the merger of DC2 with and into DC1, the former shareholders of DC1 shall be treated as receiving stock of a domestic corporation in exchange for their DC1 stock.

Example 12. Publicly traded foreign partnership not treated as a surrogate foreign corporation. (i) *Facts*. The facts are the same as in *Example 11* of this section, except that, after the acquisition, the expanded affiliated group that includes HPS (treated as a foreign corporation for this purpose) has substantial business activities in Country A when compared to the total business activities of the expanded affiliated group.

(ii) *Analysis*. Under paragraph (h)(1) of this section, for purposes of section 7874 HPS is treated as a foreign corporation and the membership interests in HPS are treated as stock of the foreign corporation. However, the foreign corporation is not treated as a surrogate foreign corporation under section 7874(a)(2)(B) because, after the acquisition, the expanded affiliated group that includes HPS has substantial business activities in Country A when compared to the total business activities of the expanded affiliated group. Therefore, under paragraph

(h)(5) of this section, section 7874 does not apply and the status of HPS as a foreign partnership is not affected. In addition, DC1 is not treated as an expatriated entity under section 7874(a) by reason of the acquisition.

Example 13. Publicly traded foreign partnership treated as a surrogate foreign corporation but not as a domestic corporation. (i) *Facts.* FPS is a publicly traded foreign partnership organized in Country A that, by reason of section 7704(c), is not treated as a corporation under section 7704(a). FPS acquires all the stock of DC1 in exchange for partnership interests in FPS. After the acquisition, the former shareholders of DC1 hold a 75 percent interest in FPS by reason of holding DC1 stock. After the acquisition, the expanded affiliated group that includes FPS (treated as a foreign corporation for this purpose) does not have substantial business activities in Country A when compared to the total business activities of the expanded affiliated group.

(ii) *Analysis.* Under paragraph (h)(1) of this section, for purposes of section 7874 FPS is treated as a foreign corporation and the partnership interests in FPS are treated as stock of the foreign corporation. FPS is treated as a surrogate foreign corporation because the conditions of section 7874(a)(2)(B) are satisfied. However, because the former shareholders of DC1 hold less than an 80 percent interest in FPS by reason of holding DC1 stock, section 7874(b) does not apply to FPS. Therefore, under paragraph (h)(4) of this section FPS continues to be treated as a foreign partnership for purposes of the Code, but section 7874(a)(1) applies to DC1 and any other expatriated entity.

Example 14. Warrant to acquire stock from the foreign corporation. (i) *Facts.* Individual A wholly owns DC1. DC1 has a $200x value. Individual B wholly owns FA. Individual C holds a warrant to acquire FA stock from FA at an exercise price of $20x. Individual A transfers all of its DC1 stock to FA in exchange solely for FA stock. At the time of the transfer, the FA stock that individual C can acquire pursuant to the warrant has a $70x value.

(ii) *Analysis.* Under paragraph (j)(2) of this section, for purposes of section 7874 individual C is treated as owning FA stock with a $50x value. This amount represents individual C's claim on the equity of FA after the acquisition ($70x value of FA stock that may be acquired pursuant to the warrant, less $20x exercise price), without taking into account the $20x individual C would be required to provide to FA upon the exercise of the warrant.

Example 15. Option to acquire stock from another shareholder. (i) *Facts.* The facts are the same as in *Example 14* except that, instead of holding a warrant issued by FA, individual C holds an option to acquire FA stock from individual B for an exercise price of $20x. At the time of the acquisition, the FA stock that individual C can acquire under the option has a $70x value.

(ii) *Analysis.* Under paragraph (j)(4) of this section, for purposes of section 7874, individual C is not treated as owning FA stock by reason of holding the option because treating the option as FA stock would have the effect of partially duplicating individual B's claim on the equity of FA at the time of the acquisition by reason of holding FA stock. However, all of the FA stock owned by individual B shall be taken into account for purposes of section 7874.

Example 16. Warrant to acquire stock from the domestic corporation. (i) *Facts.* A DC1 employee holds a warrant to acquire DC1 stock from DC1. In connection with the acquisition by FA of substantially all of the properties held by DC1, the DC1 employee receives a warrant from FA to acquire 15 shares of FA stock in exchange for the warrant to acquire DC1 stock.

(ii) *Analysis.* Under paragraph (j)(1) of this section, for purposes of section 7874 the warrant held by the DC1 employee is treated as DC1 stock with a value equal to the employee's claim on the equity of DC1 immediately before the acquisition. Further, under paragraph (j)(2) of this section, for purposes of section 7874 the DC1 employee is treated as holding FA stock with a value equal to the employee's claim on the equity of FA after the acquisition by reason of holding the warrant to acquire DC1 stock (treated as DC1 stock for this purpose).

Example 17. Stock in a subsidiary treated as stock of a foreign parent corporation. (i) *Facts.* (A) Individuals A and B equally own DC1. FA, a newly formed corporation, issues stock in a public offering for cash. FA contributes part of the cash from the public offering to DC2, a newly-formed corporation, in exchange for all the stock of DC2. DC2 merges with and into DC1 with DC1 surviving. Pursuant to the merger agreement, individuals A and B exchange their DC1 stock for cash and shares of class B stock of DC1. Following the merger FA owns all the class A stock of DC1. FA holds few assets other than the class A stock of DC1. Individuals A and B own all the class B stock of DC1. DC1 has no other class of stock outstanding.

(B) The class B stock entitles individuals A and B to dividend distributions approximately equal to any dividend distributions made by FA with respect to its publicly traded stock. In certain circumstances, the class B stock also permits individuals A and B to require DC1 to redeem the stock at fair market value. The class B stock does not provide individuals A and B voting rights with respect to FA.

(ii) *Analysis.* The dividend rights provided by the class B stock are substantially similar in all material respects to the dividend rights provided by the FA stock. In addition, because FA holds few assets other than the class A stock, the value of the class B stock held by individuals A and B is approximately equal to the value of a corresponding amount of publicly traded FA stock. The distribution rights on liquidation (or redemption) provided by the class B stock, therefore, are substantially similar in all material respects to the distribution rights on liquidation (or redemption) provided by the FA stock. As a result, the distribution rights provided by the class B stock are substantially similar in all material respects to the distribution rights provided by the publicly traded FA stock. Thus, if treating the class B stock as FA stock would have the effect of treating FA as a surrogate foreign corporation, under paragraph (k)(1) of this section the class B stock shall be treated as FA stock for purposes of section 7874.

Example 18. Partnership interest treated as stock of foreign acquiring corporation. (i) *Facts.* (A) Individuals A and B equally own DC1. FA, a newly-formed corporation, issues stock in a public offering for cash. Individuals A and B and FA organize FPS. FA transfers part of the cash from the public offering to FPS in exchange for a class A partnership interest. FA holds few assets other than the class A partnership interest. Individuals A and B transfer their DC1 stock to FPS in exchange for class B partnership interests.

(B) The class B partnership interests entitle individuals A and B to cash distributions from FPS approximately equal to any dividend distributions made by FA with respect to its publicly traded stock. In certain circumstances, the class B partnership interests also permit individuals A and B to require FPS to redeem the interests in exchange for cash equal to the value of an amount of FA stock as determined on the redemption date. The class B partnership interests do not provide individuals A or B voting rights with respect to FA.

(ii) *Analysis.* The non-liquidating distribution rights provided by the class B partnership interests are substantially similar in all material respects to the dividend rights provided by the FA stock. Because FA holds few assets other than the class A partnership interest, the value of the class B partnership interests held by individuals A and B is approximately equal to a corresponding amount of FA stock. The distribution rights on liquidation (or redemption) provided by the class B partnership interests, therefore, are substantially similar in all material respects to distribution rights on liquidation (or redemption) provided by the FA stock. Thus, the distribution rights provided by the class B partnership interests are substantially similar in all material respects to the distribution rights provided by the publicly traded FA stock. As a result, if treating the class B partnership interests as FA stock would have the effect of treating FA as a surrogate foreign corporation, under paragraph (k)(1) of this section the class B partnership interests shall be treated as FA stock for purposes of section 7874.

Example 19. Creditor treated as a shareholder. (i) *Facts.* Individuals A and B equally own DC1. The liabilities of DC1 exceed the value of its assets. Pursuant to a plan, FA, a newly-formed corporation, acquires substantially all of the properties held by DC1 in exchange solely for FA stock. Pursuant to the plan, the DC1 stock held by individuals A and B is cancelled, and the creditors of DC1 receive all the FA stock in exchange for their claims against DC1.

(ii) *Analysis.* Because immediately before the first date on which properties are acquired as part of the acquisition described in section 7874(a)(2)(B)(i) the liabilities of DC1 exceed the value of its assets, under paragraph (k)(2)(i) of this section, for purposes of section 7874 the creditors of DC1 are treated as shareholders of DC1 and the creditors' claims against DC1 are treated as DC1 stock. Therefore, for purposes of section 7874(a)(2)(B)(ii) the FA stock received by the creditors of DC1 by reason of their claims against DC1 is considered held by former shareholders of DC1 by reason of holding DC1 stock.

Example 20. Conversion to a domestic corporation and application of section 367. (i) *Facts.* Individuals A and B are United States persons and equally own DC1. Pursuant to a plan, individuals A and B transfer their DC1 stock to FA in exchange solely for 80 percent of the outstanding FA stock. After the acquisition, the expanded affiliated group that includes FA does not have substantial business activities in Country A when compared to the total business activities of the expanded affiliated group.

(ii) *Analysis.* Under paragraph (c)(1)(i) of this section, for purposes of section 7874(a)(2)(B)(i) FA

is treated as acquiring all of the properties held by DC1 on the date of the stock acquisition. After the acquisition, the former shareholders of DC1 own 80 percent of the stock of FA by reason of holding DC1 stock. Therefore, FA is a surrogate foreign corporation that is treated as a domestic corporation under section 7874(b). Under paragraph (m)(1) of this section, except for purposes of determining whether FA is treated as a surrogate foreign corporation, the conversion of FA to a domestic corporation shall constitute a reorganization described in section 368(a)(1)(F) that occurs immediately before the stock acquisition. Section 367 applies to the conversion of FA to a domestic corporation. See, for example, §§1.367(b)–2 and 1.367(b)–3 for the consequences of the conversion. Under paragraph (m)(3) of this section, section 367 does not apply to the transfers of DC1 stock by individuals A and B to FA.

(o) *Effective/applicability date*—(1) *Temporary regulations filed on* June 9, 2009. This section shall apply to acquisitions completed on or after June 9, 2009. However, taxpayers may apply this section to acquisitions completed before June 9, 2009, if this section is applied consistently to all acquisitions completed before such date.

(2) *Application of prior temporary regulations to certain acquisitions completed on or after June 6, 2006*. Section 1.7874–2T, as contained in 26 CFR part 1 revised as of April 1, 2009, shall not apply to acquisitions completed on or after June 6, 2006, pursuant to a written agreement that was (subject to customary conditions) binding on December 28, 2005, and at all times thereafter (binding commitment). A binding commitment shall include options and similar interests entered into in connection with one or more written agreements described in the preceding sentence. Accordingly, §1.7874–2T, as contained in 26 CFR part 1 revised as of April 1, 2009, shall not apply to acquisitions that occur, in whole or in part, as a result of the exercise of such options or similar interests.

(p) *Expiration date*. The applicability of this section expires on or before June 8, 2012.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved June 8, 2009.

Michael Mundaca,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 9, 2009, 11:15 a.m., and published in the issue of the Federal Register for June 12, 2009, 74 F.R. 27920)

Part III. Administrative, Procedural, and Miscellaneous

Tribal Economic Development Bonds

Notice 2009–51

SECTION 1. PURPOSE

This notice solicits applications for allocations of the $2 billion national bond volume limitation authority ("volume cap") to issue tribal economic development bonds ("Tribal Economic Development Bonds") under new § 7871(f) of the Internal Revenue Code (the "Code"). This notice also provides related guidance on the following: (1) eligibility requirements that a project must meet to be considered for a volume cap allocation, (2) application requirements, deadlines, and forms for requests for volume cap allocations, (3) the method that the Internal Revenue Service ("IRS") and the Department of the Treasury ("Treasury") will use to allocate the volume cap, and (4) certain interim guidance in this area.

SECTION 2. INTRODUCTION

Section 1402 of Title I of Division B of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111–5, 123 Stat. 115 (2009) (the "Act"), added new § 7871(f) to the Code. In general, the purpose of new § 7871(f) is to give Indian tribal governments greater flexibility to use tax-exempt bonds to finance economic development projects than is allowable under the existing standard of § 7871(c). The more restrictive standard under § 7871(c) generally limits the use by Indian tribal governments of tax-exempt bonds to the financing of certain activities that constitute essential governmental functions customarily performed by State and local governments with general taxing powers and certain manufacturing facilities. The more flexible standard under new § 7871(f) generally allows Indian tribal governments to use tax-exempt bonds under the new $2 billion volume cap to finance any economic development projects (excluding certain gaming facilities and projects located outside of Indian reservations as provided in § 7871(f)(3)(B)) or other activities for which State or local governments could use tax-exempt bonds under § 103.

State and local governments generally can use tax-exempt governmental bonds to finance an unspecified broad range of projects and activities so long as (1) not more than 10 percent of the bond proceeds are used for private business use and (2) the debt service on no more than 10 percent of bond proceeds is payable or secured from payments or property used for private business use. In addition, special rules under § 141(b)(3) and § 141(c) further limit the use of tax-exempt governmental bonds in certain circumstances involving disproportionate or unrelated private business use and private loans.

In addition, State and local governments can use tax-exempt qualified private activity bonds to finance certain specified types of projects and activities without regard to the level of private involvement. State and local governments can issue qualified tax-exempt private activity bonds under § 141(e) and related provisions for projects and activities, including the following : (1) airports, (2) docks and wharves, (3) mass commuting facilities, (4) facilities for the furnishing of water, (5) sewage facilities, (6) solid waste disposal facilities, (7) qualified low-income residential rental multifamily housing projects, (8) facilities for the local furnishing of electric energy or gas, (9) local district heating or cooling facilities, (10) qualified hazardous waste facilities, (11) high-speed intercity rail facilities, (12) environmental enhancements of hydroelectric generating facilities, (13) qualified public educational facilities, (14) qualified green buildings and sustainable design projects, (15) qualified highway or surface freight transfer facilities, (16) qualified mortgage bonds or qualified veterans mortgage bonds for certain single-family housing mortgage loans, (17) qualified small issue bonds for certain manufacturing facilities, (18) qualified student loan bonds, (19) qualified redevelopment bonds, and (20) qualified 501(c)(3) bonds for the exempt charitable and educational activities of § 501(c)(3) nonprofit organizations.

Finally, State and local governments can use tax-exempt bonds in "refunding issues," as defined in § 1.150–1(d) of the Income Tax Regulations, to refinance prior bonds, subject to certain restrictions, including a restriction under § 149(d) against not more than one "advance refunding issue," as defined in § 1.150–1(d)(4), for tax-exempt governmental bonds, and a prohibition against any advance refunding issue for tax-exempt qualified private activity bonds.

Thus, subject to the restrictions of § 7871(f)(3)(B), Indian tribal governments can use Tribal Economic Development Bonds to finance a broad range of governmental projects, including hotels, convention centers, or golf courses, as well as projects involving certain qualified private activities, to the same extent and subject to the same limitations imposed on State and local governments. The Tribes can also, subject to the limitations of § 7871(f)(3)(B), use the Bonds for refunding issues, to the same extent as State and local governments.

SECTION 3. BACKGROUND

Section 7871(a)(4) provides that, subject to § 7871(c), an Indian tribal government is to be treated as a State for purposes of § 103 (relating to State and local bonds). Section 7871(c)(1) provides generally that, except for obligations for certain manufacturing facilities described in § 7871(c)(3), § 103(a) shall apply to any obligation issued by an Indian tribal government (or subdivision thereof) only if such obligation is part of an issue substantially all of the proceeds of which are to be used in the exercise of any essential governmental function. Section 7871(e) provides that for purposes of § 7871 the term "essential governmental function" shall not include any function which is not customarily performed by State and local governments with general taxing power.

New §7871(f)(1) added by the Act provides that the Treasury Department shall allocate the $2 billion national volume cap for Tribal Economic Development Bonds among the Indian tribal governments in such manner as the Treasury Department, in consultation with the Secretary of the Interior, determines appropriate. Section 7871(f)(2)(A) provides that, notwithstanding the provisions of § 7871(c), Tribal Eco-

nomic Development Bonds are treated for purposes of the Code as if they were issued by a State. Section 7871(f)(2)(B) provides that with respect to Tribal Economic Development Bonds, the Indian tribal government issuing such bonds and any instrumentality of such Indian tribal government are to be treated as a State for purposes of § 141. Section 7871(f)(2)(C) provides that the § 146 volume cap limitations on private activity bonds do not apply to Tribal Economic Development Bonds.

Section 7871(f)(3)(A) defines a Tribal Economic Development Bond generally to mean any bond issued by an Indian tribal government the interest on which would be exempt from tax under § 103 if issued by a State or local government and which is designated by the Indian tribal government as a Tribal Economic Development Bond for purposes of § 7871(f).

Section 7871(f)(3)(B) further provides that the term Tribal Economic Development Bond shall not include any bond issued as part of an issue if any portion of the proceeds of such issue are used to finance: (1) any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted or housed or any other property actually used in the conduct of such gaming or (2) any facility located outside the Indian reservation (as defined in § 168(j)(6)). Section 168(j)(6) provides that the term "Indian reservation" means a reservation as defined in § 3(d) of the Indian Financing Act of 1974, 25 U.S.C. § 1452(d) applied by treating the term "Indian reservations in Oklahoma" as including only lands which are within the jurisdictional area of an Oklahoma Indian tribe (as determined by the Secretary of the Interior) and which are recognized by the Secretary of the Interior as eligible for trust land status under 25 CFR Part 151 (as in effect on the date of the enactment of this sentence) or a reservation defined in § 4(10) of the Indian Child Welfare Act of 1978, 25 U.S.C. 1903(10)

Section 7871(f)(3)(C) provides that the maximum aggregate face amount of bonds which may be designated by any Indian tribal government under § 7871(f)(3)(A) may not exceed the amount of national Tribal Economic Development Bond volume cap allocated to such Indian tribal government under § 7871(f)(1).

SECTION 4. APPLICATION REQUIREMENTS IN GENERAL

Each application for an allocation of the Tribal Economic Development Bond volume cap under § 7871(f)(1) ("Application") must be prepared and submitted in accordance with this section. In order for an Application to comply with this section, among other things, the Application must be prepared in substantially the form attached to this notice as Appendix A, subject to such minor changes or variations as the IRS and the Treasury Department may approve in their discretion. This notice, including Appendix A, may be found on the IRS web site at *http://www.irs.gov/taxexemptbond/index.html* or *http://www.irs.gov/pub/irs-drop/*. By submitting an Application, the applicant agrees to comply with the requirements of this notice.

a. *Qualified issuer*. An Application must be submitted by an Indian tribal government. Section § 7701(a)(40)(A) defines an Indian tribal government as the governing body of any tribe, band, community, village, or group of Indians, or Alaska Natives, which is determined by the Secretary, after consultation with the Secretary of the Interior, to exercise governmental functions. Section 2.01 of Revenue Procedure 2008–55, 2008–39 I.R.B. 768, provides that an Indian tribal entity that appears on the most recent list published by the Department of the Interior in the Federal Register pursuant to the Federally Recognized Indian Tribe List Act of 1994, Pub. L. 103–454, 108 Stat. 4791 ("List Act"), is designated an Indian tribal government for purposes of § 7701(a)(40). Section 2.03 of Rev. Proc. 2008–55 further provides that a tribe that does not appear on the most recent list published by the Department of the Interior in the Federal Register pursuant to the requirements of the List Act nonetheless will be treated as an Indian tribal government for purposes of § 7701(a)(40) if the tribe has been acknowledged as a federally recognized Indian tribe, as stated in a letter from the Department of the Interior. An Application must identify the Indian tribal government, including the Indian tribal government's Federal tax identification number, and either: (1) state that the entity is included on the most recent list published by the Department of the Interior in the Federal Register pursuant to the List Act, or (2) provide the letter from the Department of the Interior stating that the tribe has been acknowledged as a federally recognized Indian tribe.

b. *Signatures*. An Application must be signed and dated by, and must include the printed name and title of, an authorized official of the Indian tribal government. For purposes of this notice, the term "authorized official of the Indian tribal government" means an officer, board member, employee, or other official of the Indian tribal government who is duly authorized to execute legal documents on behalf of the Indian tribal government in connection with incurring debt of the Indian tribal government (*e.g.*, a tribal chairperson, chief executive officer, or chief financial officer), similar to the kind of duly authorized official of an Indian tribal government who would be authorized to execute documents in connection with an Indian tribal government's declaration of official intent to reimburse expenditures from the proceeds of a borrowing under § 1.150–2(e).

c. *Contact person*. An Application must designate one or more persons with knowledge of the project that the qualified issuer duly authorizes to discuss with the IRS any information relating to the Application. The designation must include the designee's name, title, telephone number, fax number, and mailing address. If a designee is not an official or officer of the issuer, the Application must include an executed Form 8821 *(Taxpayer Information Authorization)* or Form 2848 *(Power of Attorney and Declaration of Representative)* authorizing the disclosure of taxpayer information specifically relating to the Application.

d. *Addresses*. An Application must be submitted by hard copy in duplicate accompanied by a copy of the Application in electronic format on compact disc ("CD") sent by mail to the Internal Revenue Service (IRS), SE:T:GE:TEB:CPM, Attention: Mark Helfer, 1122 Town & Country Commons, St. Louis, Missouri 63017.

e. *Due date*. To receive an allocation from the first $1 billion of volume cap being allocated ("First Allocation"), an Application must be filed with the IRS on or before the Application deadline of August 15, 2009 ("First Allocation Deadline"). To

receive an allocation from the remaining volume cap ("Second Allocation"), an Application must be filed with the IRS after August 15, 2009, and on or before January 1, 2010 ("Second Allocation Deadline"). See section 7 for further discussion of the two allocations.

f. *Project description*. Each Application must contain the information required by this subsection f.

(i) *Qualified project*. Each Application must describe in reasonable detail the project to be financed with the proceeds of the Tribal Economic Development Bonds. The Application must indicate the expected date that the acquisition and construction of the project will commence and the expected date that the project will be placed in service.

(ii) *Location of project*. The Application must include a certification that the project's location is within the Indian tribal government's reservation.

(iii) *Project not used for gaming purposes*. The Application must contain a certification that no portion of the proceeds of any Tribal Economic Development Bonds issued pursuant to the application will be used to finance any portion of a building in which class II or class III gaming, as defined in section 4 of the Indian Gaming Regulatory Act, is conducted or housed, or any other property actually used in the conduct of such gaming. For a safe harbor standard regarding certain determinations with respect to separate buildings, see section 10 of this notice.

(iv) *Regulatory approvals*. The Application must state whether all necessary Federal, State and local regulatory approvals for the project have been obtained and, if those approvals have not yet been obtained, the Application must describe the Indian tribal government's plan for obtaining them and the time frame during which the Indian tribal government expects to receive them.

g. *Plan of financing*. The Application must contain (1) a reasonably detailed description of the plan of financing for the project, including all reasonably expected sources (*e.g.*, a public offering through a named underwriter or a private placement to a named institution) and uses of financing, including financing from the Tribal Economic Development Bonds and from other sources, (2) the status of all financing, including the name and addresses of all entities expected to provide any financing, (3) the anticipated date of issuance of the Tribal Economic Development Bonds and any expected purchasers of the Tribal Economic Development Bonds, (4) the sources of security and repayment for the Tribal Economic Development Bonds, (5) the aggregate face amount of Tribal Economic Development Bonds expected to be issued for the project, and (6) the issuer's reasonably expected schedule for spending proceeds of the Tribal Economic Development Bonds. If the Indian tribal government intends to use the proceeds of Tribal Economic Development Bonds to reimburse amounts paid with respect to a qualified project, the Application must demonstrate that the requirements under § 1.150–2 of the Income Tax Regulations will be met.

h. *Dollar amount of allocation requested*. The Application must specify the dollar amount of the volume cap requested for the project.

i. *Statement of readiness to issue*. An Application for an allocation of volume cap from the First Allocation must contain the statement that the issuer reasonably expects to issue any Tribal Economic Development Bonds, pursuant to the requested allocation of volume cap, on or before December 31, 2010. An Application for an allocation of volume cap from the Second Allocation must contain a statement that the issuer reasonably expects to issue any Tribal Economic Development Bonds pursuant to the requested allocation of volume cap on or before December 31, 2011.

SECTION 5. REQUIRED DECLARATIONS IN APPLICATIONS

Each Application submitted under this notice must include the following declaration signed and dated by an authorized official of the Indian tribal government: "Under penalties of perjury, I declare that I have examined this document and, to the best of my knowledge and belief, all of the facts contained herein are true, correct, and complete."

SECTION 6. CONSENT TO DISCLOSURE OF ALLOCATION

In order to provide the public with information on how the volume cap has been allocated and to facilitate oversight of the Tribal Economic Development Bond program, the IRS intends to publish the results of the allocation process. The information will be most useful to the public if it identifies the specific allocations awarded. Pursuant to § 6103, consent is required in order for the IRS to disclose identifying information with respect to applicants awarded an allocation. Therefore, the IRS requests that each applicant submit with the Application a declaration, consenting to the disclosure by the IRS of the name of the issuer, the type and location of the project that is the subject of the Application, and the amount of the Tribal Economic Development Bond volume cap allocation awarded to that applicant if the Applicant receives an allocation. To provide valid consent, the declaration must be in the form set forth in Appendix B. An applicant is not required to provide a declaration consenting to disclosure in order to receive an allocation. The IRS will not publish identifying information with respect to applications that are not awarded an allocation of volume cap or while applications are pending.

SECTION 7. VOLUME CAP ALLOCATIONS AND METHODOLOGY

a. *First Allocation*. Tribal Economic Development Bond volume cap under § 7871(f) will be allocated in at least two tranches. The first $1 billion in volume cap will be allocated in accordance with this section for qualified projects for which Applications meeting the requirements of this notice have been filed with the IRS on or before the First Allocation Deadline. If the total amount of volume cap requested in all applications received on or before the First Allocation Deadline does not exceed $1 billion then each qualified project will be allocated the amount of volume cap requested, and any amount of the first $1 billion in volume cap remaining will be available for allocation as part of the Second Allocation. If the total amount of volume cap requested in all applications received on or before the First Allocation Deadline exceeds $1 billion, than each qualified project will be allocated the amount of volume cap requested reduced pro rata such that the total amount allocated as part of the First Allocation does not exceed $1 billion. Applicants

receiving a reduced allocation may submit an application requesting the remainder of the allocation before the Second Allocation Deadline.

b. *Second Allocation*.

(1)The Second Allocation will allocate the second $1 billion plus any portion of the first $1 billion not allocated as part of the First Allocation (the "Second Allocation Amount"). The Second Allocation will be allocated in accordance with this section for qualified projects for which applications meeting the requirements of this notice have been filed with the IRS on or before the Second Allocation Deadline set forth in this notice. If the total amount of volume cap requested in all applications received on or before the Second Allocation Deadline does not exceed the Second Allocation Amount, then each applicant will be allocated the amount of volume cap requested and any volume cap remaining may be available for allocation by the IRS as part of an allocation process to be announced by the IRS at some future date. If the total amount of volume cap requested in all applications received on or before the Second Allocation Deadline exceed the Second Allocation Amount then each applicant will be allocated the amount of volume cap requested reduced *pro rata* such that the total amount allocated as part of the Second Allocation does not exceed the Second Allocation Amount.

(2) Applicants for any subsequent allocation other than the First Allocation must include a description of the project, or any related project, for which a prior allocation was made, as well as the name of the applicant that received the allocation. For this purpose, related projects include facilities that are owned by the same Indian tribal government, a political subdivision of the Indian tribal government, or an entity controlled by the Indian tribal government, which are (i) located at or near the same site, and (ii) are integrated, interconnected, or directly or indirectly dependent on each other based on all the facts and circumstances

c. *Limit on amounts awarded to any one Indian tribal government*. No Indian tribal government will be awarded allocations from the First Allocation for a total amount exceeding $30 million. For purposes of this limitation, an Indian tribal government includes the Indian tribal government, as well as political subdivisions of, and other entities controlled by, the Indian tribal government. Although the IRS expects that a similar limitation will apply to amounts allocated as part of the Second Allocation, or any subsequent allocation, the IRS reserves the right to raise or lower the limitation or abolish it entirely.

d. *Joint projects*. An Indian tribal government may submit an application for an allocation to finance the Indian tribal government's share of a joint project all of which will be owned by Indian tribal governments or which will, in part, be owned by an entity that is not an Indian tribal government, provided that the joint project will be located entirely on one or more of the reservations of any of the Indian tribal governments receiving an allocation with respect to such project. For this purpose, the type of joint ownership of facilities to be financed with Tribal Economic Development Bonds include only those recognized under the private activity bond restrictions on tax-exempt bonds under § 141.

e. *On behalf of issuers*.

(1) An Indian tribal government that receives an allocation may designate an "on behalf of issuer," within the rules applicable to bonds issued under § 103, to issue the Tribal Economic Development Bonds on its behalf.

(2) An Indian tribal government that receives an allocation may assign the allocation to a pool bond issuer who is otherwise an Indian tribal government for the purpose of issuing Tribal Economic Development Bonds the proceeds of which will be loaned to the Indian tribal government who received the allocation. Pooled Tribal Economic Development Bonds will be subject to the provisions of § 149(f).

(3) The proceeds of any bonds issued by an "on behalf of" issuer or a pool issuer will be treated as if they were proceeds of bonds issued by the Indian tribal government that received the allocation.

f. *Forfeiture of allocation*. If bonds are not issued by December 31, 2010, for any or all of the allocation received by an issuer pursuant to the First Allocation, then such allocation is treated as forfeited. If bonds are not issued by December 31, 2011, for any or all of the allocation received by an issuer pursuant to the Second Allocation, then such allocation is treated as forfeited. Any allocation amounts treated as forfeited may be available for allocation by the IRS as part of an allocation process to be announced by the IRS at some future date. Issuers must notify the IRS at least 30 days before the expiration of the period during which bonds may be issued pursuant to an allocation if they do not intend to issue bonds pursuant to such allocation.

SECTION 8. INSUBSTANTIAL DEVIATIONS FROM APPLICATION PROVISIONS

Generally, any allocation of Tribal Economic Development Bond volume cap is valid for purposes of § 7871, if bonds are issued pursuant to an allocation and are used to finance the project described in the Application. An allocation of Tribal Economic Development Bond volume cap is also valid notwithstanding insubstantial deviations from the information submitted in the Application. Whether a deviation with respect to the information submitted in the Application is insubstantial is determined based on all the facts and circumstances using criteria similar to those used under § 5f.103–2(f)(2) and Prop. Reg. § 1.147(f)–1(b)(6), as amended from time to time, relating to the insubstantial deviation in the information required for public approval of an issue of tax-exempt bonds under § 147(f) of the Code. Applications for approval of specific insubstantial deviations must be submitted by hard copy and in electronic format on CD sent by mail to Internal Revenue Service (IRS), SE:T:GE:TEB:CPM, Attention: Mark Helfer, 1122 Town & Country Commons, St. Louis, Missouri 63017. An Application for approval of a specific insubstantial deviation must include: (a) a detailed description of the proposed deviation, (b) facts establishing the continued technical viability of the project and that no other taxpayer, State or local government or Indian tribal government will be prejudiced, (c) a copy of the allocation letter issued by the IRS, and (d) a declaration pursuant to section 5 of this notice signed by an authorized person in accordance with section 4.b. of this Notice.

SECTION 9. INFORMATION REPORTING

Subject to updated IRS information reporting forms or procedures, an issuer

of Tribal Economic Development Bonds should complete Part II of Form 8038–G by checking the box on Line 18 (Other), writing "Tribal Economic Development Bonds" in the space provided for the bond description, and entering the issue price of the Tribal Economic Development Bonds in the Issue Price column. For purposes of this notice, the term "issue" has the meaning used for tax-exempt bond purposes in § 1.150–1(c).

SECTION 10. RELIANCE ON NOTICE AND INTERIM GUIDANCE

(a) *Generally*

Pending the promulgation and effective date of applicable future regulations or other public administrative guidance, taxpayers may rely on the interim guidance provided in this notice.

(b) Safe Harbor Definition of Building

Section 7871(f)(3)(B) provides that the term Tribal Economic Development Bond does not include any bond issued as part of an issue if any portion of the proceeds of the issue are used to finance any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted or housed or any other property actually used in the conduct of those classes of gaming. As a safe harbor, a structure will be treated as a separate building if it has an independent foundation, independent outer walls and an independent roof. Connections (*e.g.,* doorways, covered walkways or other enclosed common area connections) between two adjacent independent walls of separate buildings may be disregarded as long as such connections do not affect the structural independence of either wall.

SECTION 11. DRAFTING INFORMATION

The principal authors of this notice are Aviva M. Roth and Timothy L. Jones of the Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury participated in its development. For further information regarding this notice, contact Aviva M. Roth or Timothy L. Jones at (202) 622–3980 (not a toll-free call). For further information about submitted Applications, contact Mark Helfer at (636) 255–1201 (not a toll-free call).

APPENDIX A

APPLICATION FOR ALLOCATION OF TRIBAL ECONOMIC DEVELOPMENT BOND VOLUME CAP

Internal Revenue Service
SE:T:GE:TEB:CPM
Attention: Mark Helfer
1122 Town & Country Commons
St. Louis, Missouri 63017

Dear Sir or Madam:

The following constitutes the application ("Application") of (Name) (the "Applicant") for allocation of tribal economic development bond ("Tribal Economic Development Bond") volume cap under § 7871(f) of the Internal Revenue Code (the "Code") (unless otherwise noted, section references herein are to the Code) to finance the project described below. (*If a single Application is used to request Tribal Economic Development Bond volume cap for more than one project, then all of the required information in the Application must be provided separately for each project.*)

1. **Name of Applicant/Issuer** _____

   Street Address _____

   City _____ State _____ Zip _____

   Telephone Number _____ Fax Number _____

   EIN _____

2. **Status of Issuer** — *(Select as appropriate)*

   The Applicant/Issuer is a "qualified issuer" under § 7871(f) because it is —

   (i) an Indian tribal entity that appears on the most recent list published by the Department of Interior in the Federal Register pursuant to the Federally Recognized Indian Tribe List Act of 1994, Pub. L. 103–454, 108 Stat. 4791 ("List"), as demonstrated by the attached documents included as Exhibit A.

   (ii) an Indian tribal government which is acknowledged as a federally recognized Indian tribe, as stated in a letter from the Department of the Interior, as demonstrated by the attached documents included as Exhibit A.

3. **Name of Project** _____

4. **Detailed Description of the Project.** A reasonably detailed description of the facility to be financed (the "Project") is set forth below or in attached Exhibit B.

_____

_____

_____

If the Project is a joint Project, please describe in detail the other owners of the project and the applicant's ownership interest in the project.

5. **Construction Commencement Date and Placed in Service Date**. The Applicant begun or expects to begin the construction, installation and equipping of the Project on _____. The Applicant expects that the Project will be placed into service on or before _____.

6. **Pool Issuances**. Does the Applicant expect to have the Tribal Economic Development Bonds issued by a pool issuer or an "on behalf of issuer"? _____

If the answer above is yes, please describe the pool issuer or on behalf of issuer and provide a statement that the pool issuer is an Indian tribal government or that the "on behalf of issuer" meets the requirements to be such an issuer under the rules applicable to bonds issued under § 103.

_____

_____

_____

7. **Location of the Project:**

Project address or physical location (do not include postal box numbers or mailing address) _____

City _____ State _____ Zip _____

Reservation where Project will be located: _____

Include in the attached Exhibit C, a certification that the Project will be located on the Applicant's reservation. If the Tribal Economic Development Bonds will be issued for a joint project please include in attached Exhibit C a certification that the Project will be located on a reservation of at least one of the Indian tribal governments receiving an allocation with respect to such Project.

8. **Information with respect to gaming.**

Include in the attached Exhibit D a certification that no portion of the proceeds of any bonds issued pursuant to the requested application will be used to finance any portion of a building in which class II or class III gaming (as defined in section 4 of the Indian Gaming Regulatory Act) is conducted or housed, or any other property actually used in the conduct of such gaming.

9. **Individual to contact** for more information about the Project:

Individual Name _____

Company Name _____

Street Address _____

City _____ State _____ Zip _____

Telephone Number _____

Fax Number _____

Email Address _____

(Include as appropriate) The contact person is not an authorized official or officer of the Applicant and a properly executed Form 8821 (or Form 2848) is included with this Application that authorizes the disclosure by the IRS of information that relates to this Application and the Project(s) described above to the contact person.

10. **Regulatory Approvals**. Identify each regulatory body, the action that must be taken, status of any pending action and the remaining timeframe required to obtain each required approval. The plan of the Applicant for obtaining such approvals is as follows: *(or attach an Exhibit)*

11. **Plan of Financing**. Include a reasonably detailed description of the plan of financing for the Project, including all reasonably expected sources and uses of financing and other funds, the status of such financing, the anticipated date of bond issuance, the sources of security and repayment for the bonds, the aggregate face amount of bonds expected to be issued for the Project, and the issuer's reasonably expected schedule for spending proceeds of the Tribal Economic Development Bonds. Attached as Exhibit E is a plan of financing for the Project.

12. **Statement of Readiness**.

a. Application for volume cap from the First Allocation. Include in Exhibit F a statement signed under penalties of perjury that the Issuer reasonably expects to issue bonds pursuant to the requested allocation by December 31, 2010.

b. Application for volume cap from the Second Allocation. Include in Exhibit F a statement signed under penalties of perjury that the Issuer reasonably expects to issue bonds pursuant to the requested allocation by December 31, 2011.

13. **Reimbursements.** *(For reimbursements, include the following statement.)* The Applicant intends to use the proceeds of Tribal Economic Development Bonds to reimburse costs of the Project in accordance with § 1.150–2. *(In addition, the Applicant must demonstrate that the requirements of § 1.150–2 will be met.*

14. **Refundings.** *(For refundings or refinancings, include the following statement.)* The Applicant intends to use the proceeds of Tribal Economic Development Bonds to refund or refinance prior debt in circumstances that would qualify for a refunding or refinancing with tax-exempt bonds by a State or local government under § 103. *(In addition, the Applicant must demonstrate that applicable requirements for such a refunding or refinancing issue will be met.)*

15. **Dollar Amount of Allocation Requested for the Project.** To finance the Project, the Applicant hereby requests a Tribal Economic Development Bond allocation in the amount of $_____.

16. **Prior Allocations for the Project.** (*If the Project or any Related Project (as defined in section 7.b.(2) of this Notice) previously received an allocation of Tribal Economic Development Bond volume cap under § 7871(f) of the Code, then this paragraph must include a statement to that effect.)* [*If applicable, include the following statement:* On (*Insert date)*, the Project previously received a Tribal Economic Development Bond volume cap allocation in the amount of $_____. A copy of the IRS allocation letter for that allocation is attached.]

17. **Assignment of allocations to another issuer.** (*If the applicant expects to assign its allocation to another qualified issuer of Tribal Economic Development Bonds as authority for the Tribal Economic Development Bond issuer to issue bonds for the project on behalf of the applicant, the applicant should provide the following statement:))*

    The Applicant expects to assign the requested allocation for Tribal Economic Development Bonds volume cap to a qualified issuer of Tribal Economic Development Bonds as authority for the Tribal Economic Development Bond issuer to issue bonds for the project on behalf of the Applicant. Applicant agrees to obtain a written commitment from the assignee Tribal Economic Development Bond issuer that it is a qualified issuer of Tribal Economic Development Bonds and that it will issue Tribal Economic Development Bonds for the project within the time frame specified in the Application for the Applicant's bonds.

18. **Penalty of Perjury Statement and Signatures**

    I hereby certify that I am an authorized officer or official of the Applicant, that I am duly authorized to execute legal documents on behalf of the Applicant in connection with incurring debt, and that I am duly authorized to execute legal documents on behalf of the Applicant in making this Application. Under penalties of perjury, I declare that (i) I have knowledge of the relevant facts and circumstances relating to this Application and the Project(s), (ii) I have examined this Application, and (iii) to the best of my knowledge and belief, all of the facts contained in this Application are true, correct and complete.

By: _____

Name: _____

Title: _____

Date: _____

EXHIBIT A

DOCUMENTS REGARDING ISSUER STATUS AS AN INDIAN TRIBAL GOVERNMENT (RESPONSE TO QUESTION 2 OF THE APPLICATION)

(Attached hereto)

EXHIBIT B

DESCRIPTION OF THE PROJECT
(RESPONSE TO QUESTION 4 OF THE APPLICATION)

(Attached hereto)

EXHIBIT C

PROJECT LOCATION ON INDIAN TRIBAL GOVERNMENT RESERVATION
(RESPONSE TO QUESTION 7 OF THE APPLICATION)

EXHIBIT D

STATEMENT WITH RESPECT TO GAMING
(RESPONSE TO QUESTION 8 OF THE APPLICATION)

EXHIBIT E

PLAN OF FINANCING
(RESPONSE TO QUESTION 11 OF THE APPLICATION)

(Attached hereto)

EXHIBIT F

STATEMENT OF READINESS TO ISSUE
(RESPONSE TO QUESTION 12 OF THE APPLICATION)

I hereby certify that I am an authorized officer or official of the Applicant, that I am duly authorized to execute legal documents on behalf of the Applicant in connection with incurring debt, and that I am duly authorized to execute legal documents on behalf of the Applicant in making this Application. Under penalties of perjury, I declare that the Applicant reasonably expects that bonds issued pursuant to the Tribal Economic Development Bond allocation to be received will be issued by [*enter either: December 31, 2010, or December 31, 2011, as applicable]*

By: _____

Name: _____

Title: _____

Date: _____

EXHIBIT B

CONSENT TO PUBLIC DISCLOSURE OF CERTAIN TRIBAL ECONOMIC DEVELOPMENT BOND APPLICATION INFORMATION

In the event that the Application of [(*Insert name of applicant here):* _____] (the "Applicant") for an allocation of authority to issue tribal economic development bonds ("Tribal Economic Development Bonds") under section 7871(f) of the Internal Revenue Code is approved, the undersigned authorized representative of the Applicant hereby consents to the disclosure by the Internal Revenue Service through publication of a Notice in the Internal Revenue Bulletin or a press release of the name of Applicant (issuer), the type and location of the facility that is the subject of the Application, and the amount of the allocation, if any, of volume cap authority to issue Tribal Economic Development Bonds for such facility. The undersigned understands that this information might be published, broadcast, discussed or otherwise disseminated in the public record.

This authorization shall become effective upon the execution hereof. Except to the extent disclosure is authorized herein, the returns and return information of the undersigned taxpayer are confidential and are protected by law under the Internal Revenue Code.

I certify that I have the authority to execute this consent to disclose on behalf of the taxpayer named below.

Date: _____ Signature: _____

Print name: _____

Title: _____

Name of Applicant-Taxpayer: _____

Taxpayer Identification Number: _____

Taxpayer's Address: _____

_____

_____

Note: Treasury Regulations require that the Internal Revenue Service must receive this consent within 60 days after it is signed and dated.

Reliance Criteria for Private Foundations and Sponsoring Organizations

Rev. Proc. 2009–32

SECTION 1. PURPOSE

This Revenue Procedure provides reliance criteria for private foundations and sponsoring organizations that maintain donor advised funds in determining whether a potential grantee is an organization described in section 509(a)(1), (2) or (3) of the Internal Revenue Code (Code).

SECTION 2. BACKGROUND

The Pension Protection Act of 2006, Pub. L. No. 109–208, 120 Stat. 780 (2006) (PPA) enacted new rules regarding grants by private foundations to certain types of supporting organizations. Under section 4942(g)(4) of the Code, as added by the PPA, the term "qualifying distribution" does not include any amount paid by a private nonoperating foundation to either (1) a Type III supporting organization (as defined in § 4943(f)(5)(A)) that is not functionally integrated, or (2) a Type I, Type II, or functionally integrated Type III supporting organization if a disqualified person of the private foundation directly or indirectly controls such supporting organization or a supported organization of the supporting organization. In addition, under § 4945(d)(4)(A), as amended by the PPA, a private foundation grant to a supporting organization described in either (1) or (2) is a taxable expenditure under § 4945, unless the private foundation exercises expenditure responsibility with respect to the grant in accordance with § 4945(h).

The PPA also added § 4966 to the Code, which imposes an excise tax on a sponsoring organization (as defined in § 4966(d)(1)) for taxable distributions (as defined in § 4966(c)). Section 4966(c)(1) defines the term "taxable distribution" to include any distribution from a donor advised fund (as defined in § 4966(d)(2)) to a disqualified supporting organization, unless the sponsoring organization exercises expenditure responsibility with respect to the distribution in accordance with § 4945(h). Section 4966(d)(4) defines the term "disqualified supporting organization" as: (1) a Type III supporting organization that is not functionally integrated, and (2) a Type I, Type II, or functionally integrated Type III supporting organization if the donor, donor advisor, or related parties of the donor or donor advisor directly or indirectly controls a

supported organization of the supporting organization.

On December 18, 2006 , the Treasury Department and the Internal Revenue Service (IRS) issued Notice 2006–109, 2006–2 C.B. 1121, to provide interim guidance regarding certain of the new rules enacted by the PPA that affect supporting organizations, donor advised funds, and private foundations that make grants to supporting organizations. In particular, section 3.01 of Notice 2006–109 provides reliance criteria for private foundations and sponsoring organizations that maintain donor advised funds in determining whether a grantee is a public charity under § 509(a)(1), (2) or (3) and whether a grantee is a Type I, Type II, or functionally integrated Type III supporting organization. With respect to the determination of whether a grantee is a public charity under § 509(a)(1), (2), or (3) for purposes of §§ 4942, 4945 and 4966, as applicable, section 3.01 of Notice 2006–109 provides that a private foundation or a sponsoring organization that maintains a donor advised fund, acting in good faith, may rely on either (1) information from the IRS Business Master File ("BMF"), or (2) the grantee's current IRS letter recognizing the grantee as exempt from federal income tax and indicating the grantee's public charity classification.

The BMF is updated monthly and, due to its large size, is available as compressed ASCII Text or Excel spreadsheet files. The files must be downloaded and uncompressed before viewing. The BMF and its corresponding instructions are available for download directly from the IRS web site. Currently, the BMF does not provide information as to whether an organization described in § 509(a)(3) is a Type I, Type II, or Type III supporting organization, nor whether a Type III supporting organization is functionally integrated.

Subsequent to the issuance of Notice 2006–109, the IRS posted a document titled "Reliance on BMF Information — Certain Determinations of Public Charity Status" on its website at *http://www.irs.gov/charities/charitable/article/0,,id=168531,00.html*, clarifying how a grantor may access BMF data for purposes of satisfying the requirements of section 3.01 of Notice 2006–109 to determine whether a grantee is a public charity under section 509(a)(1), (2) or (3). The document provides that in lieu of downloading the BMF directly from the IRS website, a private foundation or a sponsoring organization that maintains a donor advised fund may use a third party to obtain the BMF information, so long as the third party provides the BMF information in a report that includes: (1) the grantee's name, Employer Identification Number, and public charity classification under § 509(a)(1), (2), or (3); (2) a statement that the information is from the most-currently available IRS monthly update to the BMF, along with the IRS BMF revision date; and (3) the date and time of the grantor's search. The report must also be in a form that the grantor can store in hard copy or electronically.

SECTION 3. SCOPE

This Revenue Procedure applies to grantor determinations of public charity status under of the Code 509(a)(1), (2) or (3) for purposes of the excise taxes imposed on grants to certain supporting organizations under sections 4942, 4945, and 4966.

SECTION 4. PROCEDURE

In determining whether a public charity is classified under 509(a)(1), (2), or (3) of the Code, a private foundation or a sponsoring organization that maintains a donor advised fund, acting in good faith, may rely on either:

(1) the grantee's current IRS letter recognizing the grantee as exempt from federal income tax and indicating the grantee's public charity classification under § 509(a)(1), (2), or (3); or

(2) information from the BMF. A grantor may download the BMF directly from the IRS website and store the relevant information in hard copy or electronically. A grantor may also obtain the BMF information from a third party, so long as the following requirements are met:

(i) The third party provides a report to the grantor that includes: (A) the grantee's name, Employer Identification Number, and public charity classification under § 509(a)(1), (2), or (3); (B) a statement that the information is from the most current update of the BMF and the BMF revision date; and (C) the date and time the information was provided to the grantor; and

(ii) The report is in a form that the grantor can store in hard copy or electronically.

EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supersedes the portions of section 3.01 of Notice 2006–109 that relate to reliance for purposes of determining whether a grantee is a public charity under section 509(a)(1), (2) or (3) of the Code. All other parts of Notice 2006–109 remain unchanged and in effect, including the separate requirements for grantors to determine whether a grantee is a Type I, Type II, or functionally integrated Type III supporting organization.

DRAFTING INFORMATION

The principal author of this revenue procedure is Patricia Thomas of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact Virginia Richardson at (202) 283–8938 (not a toll-free call).

Part IV. Items of General Interest

Withdrawal of Notice of Proposed Rulemaking and Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Guidance Under Section 7874 Regarding Surrogate Foreign Corporations

REG–112994–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking and notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS and the Treasury Department are issuing temporary regulations (T.D. 9453) concerning the treatment of a foreign corporation as a surrogate foreign corporation under section 7874(a)(2)(B) of the Internal Revenue Code (Code). The temporary regulations primarily affect domestic corporations and partnerships (and certain parties related thereto), and certain foreign corporations that acquire substantially all of the properties of such domestic corporations or partnerships. The text of the temporary regulations serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by September 10, 2009.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–112994–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–112994–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–112994–06).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, S. James Hawes at (202) 622–3860; concerning submissions of comments and a request for a public hearing, contact Funmi Taylor at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

The temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 7874 of the Code. The temporary regulations address certain issues relating to the treatment of a foreign corporation as a surrogate foreign corporation under section 7874(a)(2)(B). The text of the temporary regulations serves as the text of these proposed regulations, and the preamble to the temporary regulations explains these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 USC Chapter 5) does not apply to these regulations. These regulations do not impose a collection of information. Pursuant to the Regulatory Flexibility Act (5 USC chapter 6), it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. The complexity and cost of a transaction to which section 7874 may apply make it unlikely that a substantial number of small entities will engage in such a transaction. In addition, any economic impact to entities affected by section 7874, large or small, is derived from the operation of the statute or its intended application, not the regulations in this notice of proposed rulemaking. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Request for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is S. James Hawes of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 USC 7805, the notice of proposed rulemaking (E6–8698) that was published in the **Federal Register** on June 6, 2006 (71 FR 32495) is withdrawn.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.7874–2 is also issued under 26 U.S.C. 7874(c)(6) and (g). * * *

Par. 2. Section 1.7874–1 is amended by revising paragraphs (e) and (g) to read as follows:

§1.7874–1 Disregard of affiliate-owned stock.

* * * * *

(e) [The text of the proposed amendments to §1.7874–1(e) is the same as the text of §1.7874–1T(e) published elsewhere in this issue of the Bulletin].

* * * * *

(g) [The text of the proposed amendment to §1.7874–1(g) is the same as the text of §1.7874–1T(g) published elsewhere in this issue of the Bulletin].

Par. 3. Section 1.7874–2 is added to read as follows:

§1.7874–2 Surrogate foreign corporation.

[The text of proposed §1.7874–2 is the same as the text of §1.7874–2T(a) through (o) published elsewhere in this issue of the Bulletin].

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 9, 2009, 11:15 a.m., and published in the issue of the Federal Register for June 12, 2009, 74 F.R. 27947)

Proposed Security, Privacy, and Business Standards for Authorized IRS e-file Providers participating in Online Filing of individual income tax returns

Announcement 2009–56

The IRS has developed six (6) new security, privacy, and business standards to better serve taxpayers and protect their information collected, processed and stored by Authorized IRS *e-file* Providers (Providers) participating in Online Filing of individual income tax returns.

These new standards are intended to supplement the Gramm-Leach-Bliley Act and the implementing rules and regulations promulgated by the Federal Trade Commission. These standards have previously been reviewed by our outside technical consultants, vetted internally, presented at two consecutive IRS Software Developers conferences, and posted on *irs.gov* for comments.

The security and privacy objectives of these standards are: setting minimum encryption standards for transmission of taxpayer information over the internet and authentication of Web site owners/operators beyond that offered by standard version SSL certificates; periodic external vulnerability scan of the taxpayer data environment; protection against bulk-filing of fraudulent tax returns; and the ability to timely isolate and investigate potentially compromised taxpayer information. These standards also address certain customer service objectives such as instant access to Web site owner/operator's contact information, and e-file Providers commitment to maintaining physical, electronic, and procedural safeguards that comply with applicable law and federal standards.

1. **Extended Validation SSL Certificate**

This standard applies to Authorized IRS *e-file* Providers participating in Online Filing of individual income tax returns that collect taxpayer information via the Internet. These Providers shall possess a valid and current Extended Validation Secure Socket Layer (SSL) certificate using SSL 3.0 / TLS 1.0 or later, and minimum 1024-bit RSA / 128-bit AES.

2. **External Vulnerability Scan**

This standard applies to Authorized IRS e-file Providers participating in Online Filing of individual income tax returns that collect, transmit, process, or store taxpayer information. These Providers shall contract with an independent third-party vendor to run weekly external network vulnerability scans of all their "system components" in accordance with the applicable requirements of the Payment Card Industry Data Security Standards (PCIDSS). All scans shall be performed by a scanning vendor certified by the Payment Card Industry Security Standards Council and listed on their current list of Approved Scanning Vendors (ASV). In addition, Providers whose systems are hosted shall ensure that their host complies with all applicable requirements of the PCIDSS.

For the purposes of this standard, "system components" is defined as any network component, server, or application that is included in or connected to the taxpayer data environment. The taxpayer data environment is that part of the network that possesses taxpayer data or sensitive authentication data.

If scan reports reveal vulnerabilities, action shall be taken to address the vulnerabilities in line with the scan report's recommendations. Retain weekly scan reports for at least one year. The ASV and the host (if present) shall be located in the United States.

3. **Information Privacy and Safeguard Policies**

This standard applies to Authorized IRS *e-file* Providers participating in Online Filing of individual income tax returns that own or operate a Web site through which taxpayer information is collected, transmitted, processed or stored. These Providers shall have written information privacy and safeguard policy consistent with the applicable government and industry guidelines. In addition, Providers' shall acquire, maintain, and display a license/accreditation seal from a consumer protection and privacy seal vendor acceptable to the IRS. The list of acceptable vendors will be made available on *www.irs.gov*.

4. **Protection Against Bulk Filing of Fraudulent Income Tax Returns**

This standard applies to Authorized IRS *e-file* Providers participating in Online Filing of individual income tax returns that own or operate a Web site through which taxpayer information is collected, transmitted, processed or stored. These Providers shall implement effective state-of-the-art technologies to protect their Web site against bulk filing of fraudulent income tax returns. Taxpayer information shall not be collected, transmitted, processed or stored otherwise.

5. **Public Domain Name Registration**

This standard applies to Authorized IRS *e-file* Providers participating in Online Filing of individual income tax returns that own or operate a Web site through which taxpayer information is collected, transmitted, processed or stored. These Providers shall have their Web site's domain name registered with a domain name registrar that is located in the United States and accredited by the Internet Corporation for Assigned Names and Numbers

(ICANN). The domain name shall be locked **and** not be private.

6. **Reporting of Security Incidents**

This standard applies to Authorized IRS *e-file* Providers participating in Online Filing of individual income tax returns that collect, transmit, process, or store taxpayer information. These Providers shall report security incidents to the IRS as soon as possible but not later than the next business day after confirmation of the incident. For the purposes of this standard, an event that can result in an unauthorized disclosure, misuse, modification, or destruction of taxpayer information shall be considered a reportable security incident. Detail instructions for submitting incident reports will be made available on *www.irs.gov*

In addition, if the Provider's Web site is the proximate cause of the incident, the Provider shall cease collecting taxpayer information via their Web site immediately upon detection of the incident and until the underlying causes of the incident are successfully resolved.

Comments may be submitted electronically to *new.efile.requirements@irs.gov* on or before September 15, 2009. Please include "Announcement 2009–56" in the subject line of any electronic communications.

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

Numerical Finding List[1]

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2009–1 through 2009–26 is in Internal Revenue Bulletin 2009–26, dated June 29, 2009.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2009–1 through 2009–26 is in Internal Revenue Bulletin 2009–26, dated June 29, 2009.

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