Internal Revenue
bulletin

Bulletin No. 2009-43
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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 2009–77, page 567.

The Twenty-Second Annual Institute on Current Issues in International Taxation, jointly sponsored by the Internal Revenue Service and the George Washington University Law School, will be held on December 10 and 11, 2009, at the J.W. Marriott Hotel in Washington, D.C.

INCOME TAX

T.D. 9458, page 547.
REG–139068–08, page 558.

Temporary and proposed regulations under section 1502 of the Code provide for an election under which a consolidated group can avoid immediately taking into account an intercompany item after the liquidation of a target corporation. Pursuant to the election, the liquidation and recontribution will be recharacterized as a cross-chain reorganization, rather than a liquidation or an upstream reorganization followed by a drop of assets.

T.D. 9465, page 542.

Final regulations under section 882 of the Code provide guidance on interest allocation for foreign corporations to coordinate with recent income tax treaties; provide guidance on the adoption of a fixed ratio election and a 30–day published LIBOR rate election in the allocation formula; modify the liability reduction election under the branch profits tax; and make miscellaneous technical corrections and clarifications.

T.D. 9466, page 551.
REG–108045–08, page 557.

Final, temporary, and proposed regulations under sections 6229(c)(2) and 6501(e) of the Code define an omission from gross income for purposes of the six-year minimum period for assessment of tax attributable to partnership items and the six-year period for assessing tax.

REG–140492–02, page 559.

This document contains a withdrawal of proposed regulations (REG–140492–02, 2004–1 C.B. 1031) under section 142(a)(6) of the Code, which defined solid waste disposal facilities. This document also reissues the withdrawn proposed regulations and updates the definition of solid waste disposal facilities for purposes of section 142(a)(6). Generally, interest on a state or local bond is excluded from gross income. However, the exclusion does not apply to a private activity bond unless the bond is a qualified bond. A qualified bond includes an exempt facility bond that meets certain requirements. Exempt facility bonds include bonds for solid waste disposal facilities. The proposed regulations define solid waste disposal facilities for purposes of exempt facility bonds. A public hearing is scheduled for January 5, 2010.

EMPLOYEE PLANS

Notice 2009–76, page 554.

Weighted average interest rate update; corporate bond indices; 30–year Treasury securities; segment rates. This notice contains updates for the corporate bond weighted average interest rate for plan years beginning in October 2009; the 24–month average segment rates; the funding transitional segment rates applicable for October 2009; and the minimum present value transitional rates for September 2009.

Finding Lists begin on page ii.
Index for July through October begins on page iv.

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 882.—Tax on Income of Foreign Corporations Connected With United States Business

26 CFR 1.882–5: Determination of interest deduction.

T.D. 9465

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

Determination of Interest Expense Deduction of Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 882(c) of the Internal Revenue Code (Code) concerning the determination of the interest expense deduction of foreign corporations engaged in a trade or business within the United States. These final regulations conform the interest expense rules to recent U.S. Income Tax Treaty agreements and adopt other changes to improve compliance.

DATES: These final regulations are effective September 28, 2009.

FOR FURTHER INFORMATION CONTACT: Anthony J. Marra, (202) 622–3870 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–2030. Responses to this collection of information are mandatory. The collection of information in these final regulations is in §1.884–1(e)(3)(iv). This information is required by the IRS to allow a taxpayer to reduce U.S. liabilities to the extent necessary to prevent the recognition of a dividend equivalent amount.

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

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

Background

On August 17, 2006, the Treasury Department and the IRS published T.D. 9281 (71 FR 47443–01, 2006–2 C.B. 517) (the temporary regulations) under section 882(c) of the Internal Revenue Code regarding the determination of a foreign corporation's interest expense allocable to income effectively connected with the conduct of a trade or business within the United States. On the same day, a notice of proposed rulemaking (REG–120509–06, 71 FR 47459, 2006–2 C.B. 570) was published by cross-reference to the temporary regulations in the **Federal Register**. See §601.601(d)(2)(ii)(*b*).

Section 1.882–5 generally requires a foreign corporation to use a three-step calculation to determine the amount of interest expense that is allocable under section 882(c) to income effectively connected (or treated as effectively connected) with the foreign corporation's conduct of a trade or business within the United States. The notice of proposed rulemaking (the proposed regulations) provided for certain changes in the three-step calculation. First, the proposed regulations revised the election to use fair market value rather than adjusted basis in valuing U.S. assets in Step 1. That revision required the taxpayer to use fair market valuations for both Step 1 purposes and the entire determination of the actual ratio in Step 2. The proposed regulations also revised the Step 2 elective fixed ratio for foreign banks, allowing a 95 percent fixed ratio to be used in lieu of the actual ratio. In Step 3, the proposed regulations allowed a foreign bank with excess U.S.-connected liabilities over U.S.-booked liabilities under the adjusted U.S. booked liabilities (AUSBL) method to elect to use the 30-day London Interbank Offering Rate (LIBOR) to calculate interest on the excess U.S.-connected liabilities.

In addition to the changes in the three-step calculation, the proposed regulations implemented guidance provided in Notice 2005–53, 2005–2 C.B. 263, regarding the interaction of §1.882–5 and U.S. income tax treaties in recognition that recent treaties expressly permit taxpayers to determine attribution of business profits to a permanent establishment by analogy to the 1995 Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (Authorized OECD Approach). For purposes of applying the branch profits tax, the proposed regulations expanded the election under §1.884–1 to allow a taxpayer to reduce U.S. liabilities to the extent necessary to prevent the recognition of a dividend equivalent amount, but not below zero. Finally, the proposed regulations clarified the application of the 1996 final regulations under §1.882–5 with respect to certain direct interest allocations, the definition of U.S.-booked liabilities, and the treatment of certain currency gain and loss for purposes of §1.882–5. The preamble of T.D. 9281 includes background information with respect to the proposed regulations and a further explanation of these provisions. See §601.601(d)(2)(ii)(*b*).

The IRS received written comments in response to the proposed regulations. No requests to speak at a public hearing were received and no hearing was held. After consideration of the comments received, the proposed regulations are adopted without substantive change by this Treasury decision, and the corresponding temporary regulations are removed. To relieve taxpayers of the burden of duplicative reporting, these final regulations coordinate the various elections provided in the three-step formula with the filing of taxpayer's Schedule I (Form 1120–F). Taxpayers filing protective tax returns under §1.882–4(a)(3)(vi) may make §1.882–5 protective elections by attaching Schedule I to a timely filed return (including extensions). Taxpayers must separately attach to the Form 1120–F, any election to reduce U.S. liabilities for branch profits tax purposes as permitted by §1.884–1(e)(3). A taxpayer's Schedule I must reflect the cumulative amount of all U.S. liability reductions.

Many of the comments received raised issues specific to certain financial transactions that require broader considerations than the interaction of §1.882–5 and those financial transactions. The Treasury Department and the IRS received a number of comments requesting that the 1996 proposed hedging regulations (INTL–0054–95, 1996–1 C.B. 844) be finalized and expanded, in certain cases, to cover interbranch activities (including currency gains and losses). Since those regulations were proposed, the increase in interdesk and interbranch hedging (in both dealer and nondealer operations) has given rise to special considerations other than the familiar limitations associated with capital and ordinary income distinctions. In this regard, the proposed 1998 global dealing regulations, for example, require special considerations as to the appropriate treatment of risk transfer agreements in similar circumstances. In light of the need for a broader consideration of these issues, the Treasury Department and the IRS are not adopting the suggestions outlined in the comments received at this time. See §601.601(d)(2)(ii)(*b*).

Commentators also suggested that the regulations adopt special rules that would govern the treatment of certain integrated financial transactions such as effectively connected sale-repurchase agreements and securities lending transactions. The commentators suggested the adoption of a direct tracing rule that would, in effect, give zero risk weighting to such assets, especially in defined dealer books consisting of sale-repurchase transactions and securities loans involving U.S. Treasuries and other government securities. The suggested rule would scale back the amount of capital that is imputed to such portfolios under either the actual ratio or the fixed ratio to reflect the economic reality that such assets are entirely debt-financed. Commentators also suggested that "netting" rules apply for offsetting notional principal contracts within discrete portfolios. Finally, commentators suggested revisions to the definition of U.S.-booked liabilities that would exclude certain conduit interbranch lending arrangements. The Treasury Department and the IRS are not adopting these suggestions at this time but continue to consider the issues raised in this context and intend to coordinate these issues, where appropriate, with similar issues in analogous contexts, such as global dealing operations and section 864(e). See Notice 2001–59, 2001–2 C.B. 315. See §601.601(d)(2)(ii)(*b*).

Section 861(a)(1)(C), as amended by the American Jobs Creation Act of 2004 provides a special source rule for interest on obligations of certain foreign partnerships and may require coordinating changes to the branch-level interest tax rules under §1.884–4. Specifically, a foreign corporate partner is not treated as paying branch interest under §1.884–4(b)(1)(i)(A) and therefore may be liable for tax on excess interest even if that foreign partner has U.S. book interest paid with respect to its distributive share of U.S. booked liabilities under §1.882–5. Accordingly, the Treasury Department and the IRS are currently considering how best to coordinate the U.S. booked liability rules with the determination of partnership branch interest so that foreign corporate partners of partnerships described in section 861(a)(1)(C) are provided similar treatment under §1.884–4 with respect to their distributive shares of interest expense as foreign corporations directly engaged in a trade or business within the United States.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. The collection of information requirement in these regulations generally only affects large foreign banks. Thus, the number of affected small entities will not be substantial and any economic impacts on those entities in complying with the collection of information would be minimal. 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.

Drafting Information

The principal author of these regulations is Anthony J. Marra of the Office of Associate Chief Counsel (International). However, other persons from the Office of Associate Chief Counsel (International) and the Treasury Department have participated in their development.

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Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.882–0 is amended by:

1. Revising the entries for §1.882–5(a)(1), (a)(1)(i), (a)(1)(ii), (a)(1)(ii)(A), (a)(1)(ii)(B), (a)(2), (a)(7), (a)(7)(i), (a)(7)(ii), (b)(2)(ii)(A), (b)(3), (c)(2)(iv), (c)(4), (d)(2)(iii)(A), and (d)(5)(ii).

2. Adding entries for §1.882–5 (a)(7)(iii), (b)(3)(i), (b)(3)(ii), (d)(5)(ii)(A), and (d)(5)(ii)(B).

3. Removing the entries for §1.882–5T.

The revisions and additions read as follows:

§1.882–0 Table of contents.

* * * * *

§1.882–5 Determination of interest deduction.

(a)(1) Overview.

(i) In general.
(ii) Direct allocations.
(A) In general.
(B) Partnership interests.
(2) Coordination with tax treaties.

* * * * *

(7) Elections under §1.882–5.
(i) In general.
(ii) Failure to make the proper election.
(iii) Step 2 special election for banks.

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(b)(2)(ii)(A) In general.

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(3) Computation of total value of U.S. assets.
(i) General rule.
(ii) Adjustment to basis of financial instruments.

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(c)(2)(iv) Determination of value of worldwide assets.

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(4) Elective fixed ratio method of determining U.S. liabilities.

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(d)(2)(iii)(A) In general.

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(5)(ii) Interest rate on excess U.S.-connected liabilities.
(A) General rule.
(B) Annual published rate election.

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Par. 3. Section 1.882–5 is amended by:

1. Revising paragraphs (a)(1), (a)(2), (a)(7), (a)(7)(i), (a)(7)(ii), (a)(7)(iii), (b)(2)(ii)(A), (b)(3), (c)(2)(iv), (c)(4), (d)(2)(ii)(B)(*2*), (d)(2)(ii)(B)(*3*), (d)(2)(iii)(A), (d)(5)(ii), (d)(6) *Example 5* and (f)(1).

The revisions read as follows:

§1.882–5 Determination of interest deduction.

(a)(1) *Overview*—(i) *In general*. The amount of interest expense of a foreign corporation that is allocable under section 882(c) to income which is (or is treated as) effectively connected with the conduct of a trade or business within the United States (ECI) is the sum of the interest allocable by the foreign corporation under the three-step process set forth in paragraphs (b), (c), and (d) of this section and the specially allocated interest expense determined under paragraph (a)(1)(ii) of this section. The provisions of this section provide the exclusive rules for allocating interest expense to the ECI of a foreign corporation under section 882(c). Under the three-step process, the total value of the U.S. assets of a foreign corporation is first determined under paragraph (b) of this section (Step 1). Next, the amount of U.S.-connected liabilities is determined under paragraph (c) of this section (Step 2). Finally, the amount of interest paid or accrued on U.S.-booked liabilities, as determined under paragraph (d)(2) of this section, is adjusted for interest expense attributable to the difference between U.S.-connected liabilities and U.S.-booked liabilities (Step 3). Alternatively, a foreign corporation may elect to determine its interest rate on U.S.-connected liabilities by reference to its U.S. assets, using the separate currency pools method described in paragraph (e) of this section.

(ii) *Direct allocations*—(A) *In general*. A foreign corporation that has a U.S. asset and indebtedness that meet the requirements of §1.861–10T (b) or (c), as limited by §1.861–10T(d)(1), shall directly allocate interest expense from such indebtedness to income from such asset in the manner and to the extent provided in §1.861–10T. For purposes of paragraph (b)(1) or (c)(2) of this section, a foreign corporation that allocates its interest expense under the direct allocation rule of this paragraph (a)(1)(ii)(A) shall reduce the basis of the asset that meets the requirements of §1.861–10T (b) or (c) by the principal amount of the indebtedness that meets the requirements of §1.861–10T (b) or (c). The foreign corporation shall also disregard any indebtedness that meets the requirements of §1.861–10T (b) or (c) in determining the amount of the foreign corporation's liabilities under paragraphs (c)(2) and (d)(2) of this section and shall not take into account any interest expense paid or accrued with respect to such a liability for purposes of paragraph (d) or (e) of this section.

(B) *Partnership interest*. A foreign corporation that is a partner in a partnership that has a U.S. asset and indebtedness that meet the requirements of §1.861–10T (b) or (c), as limited by §1.861–10T(d)(1), shall directly allocate its distributive share of interest expense from that indebtedness to its distributive share of income from that asset in the manner and to the extent provided in §1.861–10T. A foreign corporation that allocates its distributive share of interest expense under the direct allocation rule of this paragraph (a)(1)(ii)(B) shall disregard any partnership indebtedness that meets the requirements of §1.861–10T (b) or (c) in determining the amount of its distributive share of partnership liabilities for purposes of paragraphs (b)(1), (c)(2)(vi), and (d)(2)(vii) or (e)(1)(ii) of this section, and shall not take into account any partnership interest expense paid or accrued with respect to such a liability for purposes of paragraph (d) or (e) of this section. For purposes of paragraph (b)(1) of this section, a foreign corporation that directly allocates its distributive share of interest expense under this paragraph (a)(1)(ii)(B) shall—

(*1*) Reduce the partnership's basis in such asset by the amount of such indebtedness in allocating its basis in the partnership under §1.884–1(d)(3)(ii); or

(*2*) Reduce the partnership's income from such asset by the partnership's interest expense from such indebtedness under §1.884–1(d)(3)(iii).

(2) *Coordination with tax treaties*. Except as expressly provided by or pursuant to a U.S. income tax treaty or accompanying documents (such as an exchange of notes), the provisions of this section provide the exclusive rules for determining the interest expense attributable to the business profits of a permanent establishment under a U.S. income tax treaty.

* * * * *

(7) *Elections under §1.882–5*—(i) *In general*. A corporation must make each election provided in this section on the corporation's original timely filed Federal income tax return for the first taxable year it is subject to the rules of this section. An amended return does not qualify for this purpose, nor shall the provisions of §301.9100–1 of this chapter and any guidance promulgated thereunder apply. Except as provided elsewhere in this section, each election under this section, whether an election for the first taxable year or a subsequent change of election, shall be made by indicating the method used on Schedule I (Form 1120–F) attached to the corporation's timely filed return. An elected method (other than the fair market

value method under paragraph (b)(2)(ii) of this section, or the annual 30-day London Interbank Offered Rate (LIBOR) election in paragraph (d)(5)(ii) of this section) must be used for a minimum period of five years before the taxpayer may elect a different method. To change an election before the end of the requisite five-year period, a taxpayer must obtain the consent of the Commissioner or his delegate. The Commissioner or his delegate will generally consent to a taxpayer's request to change its election only in rare and unusual circumstances. After the five-year minimum period, an elected method may be changed for any subsequent year on the foreign corporation's original timely filed tax return for the first year to which the changed election applies.

(ii) *Failure to make the proper election.* If a taxpayer, for any reason, fails to make an election provided in this section in a timely fashion, the Director of Field Operations may make any or all of the elections provided in this section on behalf of the taxpayer, and such elections shall be binding as if made by the taxpayer.

(iii) *Step 2 special election for banks.* For the first taxable year for which an original income tax return is due (including extensions) after August 17, 2006, in which a taxpayer that is a bank as described in paragraph (c)(4) of this section is subject to the requirements of this section, a taxpayer may make a new election to use the fixed ratio on an original timely filed return. A new fixed ratio election may be made in any subsequent year subject to the timely filing and five-year minimum period requirements of paragraph (a)(7)(i) of this section. A new fixed ratio election under this paragraph (a)(7)(iii) is subject to the adjusted basis or fair market value conforming election requirements of paragraph (b)(2)(ii)(A)(*2*) of this section and may not be made if a taxpayer elects or maintains a fair market value election for purposes of paragraph (b) of this section. Taxpayers that already use the fixed ratio method under an existing election may continue to use the new fixed ratio at the higher percentage without having to make a new five-year election in the first year that the higher percentage is effective.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(A) *In general*—(*1*) *Fair market value conformity requirement.* A taxpayer may elect to value all of its U.S. assets on the basis of fair market value, subject to the requirements of §1.861–9T(g)(1)(iii), and provided the taxpayer is eligible and uses the actual ratio method under paragraph (c)(2) of this section and the methodology prescribed in §1.861–9T(h). Once elected, the fair market value must be used by the taxpayer for both Step 1 and Step 2 described in paragraphs (b) and (c) of this section, and must be used in all subsequent taxable years unless the Commissioner or his delegate consents to a change.

(*2*) *Conforming election requirement.* Taxpayers that as of the effective date of this paragraph (b)(2)(ii)(A)(*2*) have elected and currently use both the fair market value method for purposes of paragraph (b) of this section and a fixed ratio for purposes of paragraph (c)(4) of this section must conform either the adjusted basis or fair market value methods in Step 1 and Step 2 of the allocation formula by making an adjusted basis election for paragraph (b) of this section purposes while continuing the fixed ratio for Step 2, or by making an actual ratio election under paragraph (c)(2) of this section while remaining on the fair market value method under paragraph (b) of this section. Taxpayers who elect to conform Step 1 and Step 2 of the formula to the adjusted basis method must remain on both methods for the minimum five-year period in accordance with the provisions of paragraph (a)(7) of this section. Taxpayers that elect to conform Step 1 and Step 2 of the formula to the fair market value method must remain on the actual ratio method until the consent of the Commissioner or his delegate is obtained to switch to the adjusted basis method. If consent to use the adjusted basis method in Step 1 is granted in a later year, the taxpayer must remain on the actual ratio method for the minimum five-year period unless consent to use the fixed ratio is independently obtained under the requirements of paragraph (a)(7) of this section. For the first taxable year for which an original income tax return is due (including extensions) after August 17, 2006, taxpayers that are required to make a conforming election under this paragraph (b)(2)(ii)(A)(*2*), may do so on an original timely filed return. If a conforming election is not made within the timeframe provided in this paragraph, the Director of Field Operations or his delegate may make the conforming elections in accordance with the provisions of paragraph (a)(7)(ii) of this section.

* * * * *

(3) *Computation of total value of U.S. assets*—(i) *General rule.* The total value of U.S. assets for the taxable year is the average of the sums of the values (determined under paragraph (b)(2) of this section) of U.S. assets. For each U.S. asset, value shall be computed at the most frequent regular intervals for which data are reasonably available. In no event shall the value of any U.S. asset be computed less frequently than monthly (beginning of taxable year and monthly thereafter) by a large bank (as defined in section 585(c)(2)) or a dealer in securities (within the meaning of section 475) and semi-annually (beginning, middle and end of taxable year) by any other taxpayer.

(ii) *Adjustment to basis of financial instruments.* For purposes of determining the total average value of U.S. assets in this paragraph (b)(3), the value of a security or contract that is marked to market pursuant to section 475 or section 1256 shall be determined as if each determination date is the most frequent regular interval for which data are reasonably available that reflects the taxpayer's consistent business practices for reflecting mark-to-market valuations on its books and records.

* * * * *

(c) * * *

(2) * * *

(iv) *Determination of value of worldwide assets.* The value of an asset must be determined consistently from year to year and must be substantially in accordance with U.S. tax principles. To be substantially in accordance with U.S. tax principles, the principles used to determine the value of an asset must not differ from U.S. tax principles to a degree that will materially affect the value of the taxpayer's worldwide assets or the taxpayer's actual ratio. The value of an asset is the adjusted basis of that asset for determining the gain or loss from the sale or other disposition of that asset, adjusted in the same manner as the basis of U.S. assets are adjusted under paragraphs (b)(2) (ii) through (iv) of this section. The rules of paragraph (b)(3) of this section apply in determining the total value of applicable worldwide assets for the taxable year, except that the minimum number of determination dates are those stated in paragraph (c)(2)(i) of this section.

* * * * *

(4) *Elective fixed ratio method of determining U.S. liabilities*. A taxpayer that is a bank as defined in section 585(a)(2)(B) (without regard to the second sentence thereof or whether any such activities are effectively connected with a trade or business within the United States) may elect to use a fixed ratio of 95 percent in lieu of the actual ratio. A taxpayer that is neither a bank nor an insurance company may elect to use a fixed ratio of 50 percent in lieu of the actual ratio.

* * * * *

(d) * * *

(2) * * *

(ii) * * *

(B)(*2*) The foreign corporation enters the liability on a set of books reasonably contemporaneously with the time at which the liability is incurred and the liability relates to an activity that produces ECI.

(*3*) The foreign corporation maintains a set of books and records relating to an activity that produces ECI and the Director of Field Operations determines that there is a direct connection or relationship between the liability and that activity. Whether there is a direct connection between the liability and an activity that produces ECI depends on the facts and circumstances of each case.

* * * * *

(iii) * * *

(A) *In general*. A liability, whether interest bearing or non-interest bearing, is properly reflected on the books of the U.S. trade or business of a foreign corporation that is a bank as described in section 585(a)(2)(B) (without regard to the second sentence thereof) if—

(*1*) The bank enters the liability on a set of books before the close of the day on which the liability is incurred, and the liability relates to an activity that produces ECI; and

(*2*) There is a direct connection or relationship between the liability and that activity. Whether there is a direct connection between the liability and an activity that produces ECI depends on the facts and circumstances of each case. For example, a liability that is used to fund an interbranch or other asset that produces non-ECI may have a direct connection to an ECI producing activity and may constitute a U.S.-booked liability if both the interbranch or non-ECI activity is the same type of activity in which ECI assets are also reflected on the set of books (for example, lending or money market interbank placements), and such ECI activities are not *de minimis*. Such U.S. booked liabilities may still be subject to paragraph (d)(2)(v) of this section.

* * * * *

(5) * * *

(ii) *Interest rate on excess U.S.-connected liabilities*—(A) *General rule*. The applicable interest rate on excess U.S.-connected liabilities is determined by dividing the total interest expense paid or accrued for the taxable year on U.S.-dollar liabilities that are not U.S.-booked liabilities (as defined in paragraph (d)(2) of this section) and that are shown on the books of the offices or branches of the foreign corporation outside the United States by the average U.S.-dollar denominated liabilities (whether interest-bearing or not) that are not U.S.-booked liabilities and that are shown on the books of the offices or branches of the foreign corporation outside the United States for the taxable year.

(B) *Annual published rate election*. For each taxable year beginning with the first year end for which the original tax return due date (including extensions) is after August 17, 2006, in which a taxpayer is a bank within the meaning of section 585(a)(2)(B) (without regard to the second sentence thereof or whether any such activities are effectively connected with a trade or business within the United States), such taxpayer may elect to compute its excess interest by reference to a published average 30-day London Interbank Offering Rate (LIBOR) for the year. The election may be made for any eligible year by indicating the rate used on Schedule I (Form 1120–F) attached to the timely filed return. Once selected, the rate may not be changed by the taxpayer. If a taxpayer that is eligible to make the 30-day LIBOR election either does not file a timely return or files a calculation that allocates interest expense under the scaling ratio in paragraph (d)(4) of this section and it is determined by the Director of Field Operations that the taxpayer's U.S.-connected liabilities exceed its U.S.-booked liabilities, then the Director of Field Operations, and not the taxpayer, may choose whether to determine the taxpayer's excess interest rate under paragraph (d)(5)(ii)(A) or (B) of this section and may select the published 30-day LIBOR rate.

(6) * * *

Example 5. U.S. booked liabilities — direct relationship. (i) *Facts*. Bank A, a resident of Country X maintains a banking office in the U.S. that records transactions on three sets of books for State A, an International Banking Facility (IBF) for its bank regulatory approved international transactions, and a shell branch licensed operation in Country C. Bank A records substantial ECI assets from its bank lending and placement activities and a mix of interbranch and non-ECI producing assets from the same or similar activities on the books of State A branch and on its IBF. Bank A's Country C branch borrows substantially from third parties, as well as from its home office, and lends all of its funding to its State A branch and IBF to fund the mix of ECI, interbranch and non-ECI activities on those two books. The consolidated books of State A branch and IBF indicate that a substantial amount of the total book assets constitute U.S. assets under paragraph (b) of this section. Some of the third-party borrowings on the books of the State A branch are used to lend directly to Bank A's home office in Country X. These borrowings reflect the average borrowing rate of the State A branch, IBF and Country C branches as a whole. All third-party borrowings reflected on the books of State A branch, the IBF and Country C branch were recorded on such books before the close of business on the day the liabilities were acquired by Bank A.

(ii) *U.S. booked liabilities*. The facts demonstrate that the separate State A branch, IBF and Country C branch books taken together, constitute a set of books within the meaning of paragraph (d)(2)(iii)(A)(*1*) of this section. Such set of books as a whole has a direct relationship to an ECI activity under paragraph (d)(2)(iii)(A)(*2*) of this section even though the Country C branch books standing alone would not. The third-party liabilities recorded on the books of Country C constitute U.S. booked liabilities because they were timely recorded and the overall set of books on which they were reflected has a direct relationship to a bank lending and interbank placement ECI producing activity. The third-party liabilities that were recorded on the books of State A branch that were used to lend funds to Bank A's home office also constitute U.S. booked liabilities because the interbranch activity the funds were used for is a lending activity of a type that also gives rise to a substantial amount of ECI that is properly reflected on the same set of books as the interbranch loans. Accordingly, the liabilities are not traced to their specific interbranch use but to the overall activity of bank lending and interbank placements which gives rise to substantial ECI. The facts show that the liabilities were not acquired to increase artificially the interest expense of Bank

A's U.S. booked liabilities as a whole under paragraph (d)(2)(v) of this section. The third-party liabilities also constitute U.S. booked liabilities for purposes of determining Bank A's branch interest under §1.884–4(b)(1)(i)(A) regardless of whether Bank A uses the Adjusted U.S. booked liability method, or the Separate Currency Pool method to allocate its interest expense under paragraph 5(e) of this section.

* * * * *

(f)(1) *Effective/applicability date*—(1) *General rule*. This section is applicable for taxable years ending on or after August 15, 2009. A taxpayer, however, may choose to apply §1.882–5T, rather than applying the final regulations, for any taxable year beginning on or after August 16, 2008 but before August 15, 2009.

§1.882–5T [Removed]

Par. 4. Section 1.882–5T is removed.

Par. 5. Section 1.884–1 is amended by revising the entries for paragraphs (e)(3)(ii), (e)(3)(iv) and (e)(5) *Example 2*.

§1.884–1 Branch profits tax.

* * * * *

(e) * * *

(3) * * *

(ii) *Limitation*. For any taxable year, a foreign corporation may elect to reduce the amount of its liabilities determined under paragraph (e)(1) of this section by an amount that does not exceed the lesser of the amount of U.S. liabilities as of the determination date, or the amount of U.S. liability reduction needed to reduce a dividend equivalent amount as of the determination date to zero.

* * * * *

(iv) *Method of election*. A foreign corporation that elects the benefits of this paragraph (e)(3) for a taxable year shall attach a statement to its return for the taxable year that it has elected to reduce its liabilities for the taxable year under this paragraph (e)(3) and that it has reduced the amount of its U.S.-connected liabilities as provided in paragraph (e)(3)(iii) of this section and shall indicate the amount of such reductions on such attachment. The cumulative amount of all U.S. liability reductions is shown on Schedule I (Form 1120–F) in addition to the separate elections attached to the timely filed return. An election under this paragraph (e)(3) must be made before the due date (including extensions) for the foreign corporation's income tax return for the taxable year.

* * * * *

(5) * * *

Example 2. Election made to reduce liabilities. (i) As of the close of 2007, foreign corporation A, a real estate company, owns U.S. assets with an E&P basis of $1000. A has $800 of liabilities under paragraph (e)(1) of this section. A has accumulated ECEP of $500 and in 2008, A has $60 of ECEP that it intends to retain for future expansion of its U.S. trade or business. A elects under paragraph (e)(3) of this section to reduce its liabilities by $60 from $800 to $740. As a result of the election, assuming A's U.S. assets and U.S. liabilities would otherwise have remained constant, A's U.S. net equity as of the close of 1994 will increase by the amount of the decrease in liabilities ($60) from $200 to $260 and its ECEP will be reduced to zero. Under paragraph (e)(3)(iii) of this section, A's interest expense for the taxable year is reduced by the amount of interest attributable to $60 of liabilities and A's excess interest is reduced by the same amount. A's taxable income and ECEP are increased by the amount of the reduction in interest expense attributable to the liabilities, and A may make an election under paragraph (e)(3) of this section to further reduce its liabilities, thus increasing its U.S. net equity and reducing the amount of additional ECEP created for the election.

(ii) In 2009, assuming A again has $60 of ECEP, A may again make the election under paragraph (e)(3) to reduce its liabilities. However, assuming A's U.S. assets and liabilities under paragraph (e)(1) of this section remain constant, A will need to make an election to reduce its liabilities by $120 to reduce to zero its ECEP in 2009 and to continue to retain for expansion (without the payment of the branch profits tax) the $60 of ECEP earned in 2008. Without an election to reduce liabilities, A's dividend equivalent amount for 2009 would be $120 ($60 of ECEP plus the $60 reduction in U.S. net equity from $260 to $200). If A makes the election to reduce liabilities by $120 (from $800 to $680), A's U.S. net equity will increase by $60 (from $260 at the end of the previous year to $320), the amount necessary to reduce its ECEP to $0. However, the reduction of liabilities will itself create additional ECEP subject to section 884 because of the reduction in interest expense attributable to the $120 of liabilities. A can make the election to reduce liabilities by $120 without exceeding the limitation on the election provided in paragraph (e)(3)(ii) of this section because the $120 reduction does not exceed the amount needed to treat the 2009 and 2008 ECEP as reinvested in the net equity of the trade or business within the United States.

(iii) If A terminates its U.S. trade or business in 2009 in accordance with the rules in §1.884–2T(a), A would not be subject to the branch profits tax on the $60 of ECEP earned in that year. Under paragraph (e)(3)(v) of this section, however, it would be subject to the branch profits tax on the portion of the $60 of ECEP that it earned in 2008 that became accumulated ECEP because of an election to reduce liabilities.

* * * * *

§1.884–1T [Removed]

Par. 6. Section 1.884–1T is removed.

Par. 7. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 8. In §602.101, paragraph (b) is amended by removing the entry for "§1.882–5T" from the table.

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

Approved September 15, 2009.

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

(Filed by the Office of the Federal Register on September 25, 2009, 8:45 a.m., and published in the issue of the Federal Register for September 28, 2009, 74 F.R. 49315)

Section 1502.—Regulations

26 CFR 1.1502–13: Intercompany transactions.

T.D. 9458

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

Modification to Consolidated Return Regulation Permitting an Election to Treat a Liquidation of a Target, Followed by a Recontribution to a New Target, as a Cross-Chain Reorganization

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 1502 of the Internal Revenue Code (Code). The change to the consolidated return regulations is necessary in light of the regulations under section 368 that were issued in October 2007 addressing transfers of assets or stock following a reorganization. The temporary regulations modify the election under which a consoli-

dated group can avoid immediately taking into account an intercompany item after the liquidation of a target corporation. The temporary regulations apply to corporations filing consolidated returns. The text of these temporary regulations also serves as the text of the proposed regulations (REG–139068–08) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on September 4, 2009.

Applicability Date: The changes reflected in these temporary regulations (§1.1502–13T(f)(5)(ii)(B)(*1*) and (*2*)) generally apply to transactions in which T's liquidation into B occurs on or after the effective date of the §1.368–2(k) regulations, October 25, 2007. For transactions in which T's liquidation into B occurs before October 25, 2007, §1.1502–13(f)(5)(ii)(B)(*1*) and (*2*) in effect prior to October 25, 2007 as contained in 26 CFR part 1, revised April 1, 2009, continue to apply.

FOR FURTHER INFORMATION CONTACT: Concerning the temporary regulations, Mary W. Lyons, (202) 622–7930; concerning submission of comments and the hearing, Oluwafunmilayo (Funmi) Taylor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1433. Responses to this collection of information are required in order for the parent of a consolidated group to make the election found in §1.1502–13T(f)(5)(ii)(B).

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

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking on this subject in this issue of the Bulletin.

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

Background and Explanation of Provisions

Section 1.1502–13(f)(5) provides that S's (the selling member in an intercompany transaction) intercompany item from a transfer to B (the buying member in an intercompany transaction) of the stock of another corporation (T) is taken into account in certain circumstances even though the T stock is never held by a nonmember of the consolidated group after the intercompany transaction. For example, if S sells all of T's stock to B at a gain, and T subsequently liquidates into B in a separate transaction to which section 332 applies, S's gain is taken into account under the matching rule. This result would also be obtained in other transactions in which B's basis in its T stock is permanently eliminated in a nonrecognition transaction, including a merger of B into T under section 368(a), a distribution by B of its T stock in a transaction described in section 355, and a deemed liquidation of T resulting from an election under section 338(h)(10). However, an election to apply §1.1502–13(f)(5)(ii)(B) is available that allows a taxpayer whose intercompany gain on subsidiary (T) stock was taken into account upon the subsidiary's liquidation to reincorporate the subsidiary to prevent the intercompany gain from being taken account at such time. Section 1.1502–13(f)(5)(ii)(B) provides:

> If section 332 applies to T's liquidation into B, and B transfers T's assets to a new member (new T) in a transaction not otherwise pursuant to the same plan or arrangement as the liquidation, the transfer is nevertheless treated for all Federal income tax purposes as pursuant to the same plan or arrangement as the liquidation. For example, if T liquidates into B, but B forms new T by transferring substantially all of T's former assets to new T, S's intercompany gain or loss generally is not taken into account solely as a result of the liquidation if the liquidation and transfer would qualify as a reorganization described in section 368(a). (Under [§1.1502–13(j)(1)], B's stock in new T would be a successor asset to B's stock in T, and S's gain would be taken into account based on the new T stock.)

1. *Results Prior to the Issuance of §1.368–2(k) Regulations.*

Prior to the issuance of the regulations under §1.368–2(k) (the –2(k) regulations) in October 2007, the election to apply §1.1502–13(f)(5)(ii)(B) triggered the application of the step transaction doctrine. Under the step transaction doctrine, the liquidation of a corporation followed by a contribution of substantially all its assets to a new corporation generally is recharacterized as a cross-chain reorganization. In a cross-chain reorganization, B's basis in the new T stock is determined by reference to its basis in the old T stock. Therefore, under §1.1502–13(j), the new T stock is a successor asset to the old T stock, and S's gain on the old T stock is not taken into account upon the liquidation of old T, but instead is taken into account by reference to the new T stock. By not immediately taking the gain into account, the purpose of §1.1502–13, that is, to provide rules that clearly reflect the income and tax liability of the group by preventing intercompany transactions from creating, accelerating, avoiding, or deferring consolidated taxable income or consolidated tax liability, is accomplished. See §1.1502–13(a)(1).

2. *Results After the Issuance of §1.368–2(k) Regulations.*

The issuance of the –2(k) regulations created a conflict with the language of §1.1502–13(f)(5)(ii)(B). Section 1.368–2(k) provides, in general, that a transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified or recharacterized as a result of one or more subsequent transfers (or successive transfers) of assets or stock, provided that the requirements of §1.368–1(d) are satisfied and the transfer(s) are described in either §1.368–2(k)(1)(i) or (ii). Under the –2(k) regulations, which are generally effective for transactions occurring on or after October 25, 2007, the liquidation of old T followed by the contribution of substantially all the old T assets to new T would now be characterized as an upstream C reorganization (if it so qualifies) followed by a section 368(a)(2)(C) drop of assets, and could no longer be recharacterized as a cross-chain reorganization. Thus, B's basis in its new T stock would not be determined by reference to B's basis in the old T stock, but by reference to the basis of old T's assets.

3. *Reason for Change.*

Section 1.1502–13(j)(1) provides that an asset is a successor asset if its basis is determined by reference to the basis of the first asset. In a cross-chain reorganization, the result prior to the issuance of the –2(k) regulations, B's basis in the new T stock would be determined by reference to the basis of the old T stock, thus the new T stock would clearly fall within the meaning of successor asset in §1.1502–13(j)(1). However, in an upstream reorganization followed by a drop of the assets to new T, the result after the issuance of the –2(k) regulations, B's basis in new T would be determined by reference to the basis of the old T assets, not the old T stock. Thus, the new T stock would not be a successor asset to the old T stock in an upstream reorganization.

Permitting an election to apply §1.1502–13(f)(5)(ii)(B) while treating the transaction as an upstream reorganization would be inconsistent with the purposes of §1.1502–13. For example, assume S sells its stock in T to B for $1,000,000 and T has a basis in its assets of $3,000,000. T then liquidates into B, which recontributes the assets to new T. If the transaction is treated as an upstream reorganization under section 368(a)(1)(C), followed by a drop of the assets under section 368(a)(2)(C), B would receive a basis in T's assets of $3,000,000 under section 362(b), and, on the drop of the assets to new T, would receive a basis in its new T stock of $3,000,000 under section 358(a). This increase in basis in the new T stock over the basis of the old T stock is inconsistent with allowing S's continued deferral of the gain on the old T stock and the purposes of §1.1502–13.

Therefore, in order to satisfy the purposes of §1.1502–13, these regulations provide that if the election to apply §1.1502–13T(f)(5)(ii)(B) is made for a transaction in which old T liquidates into B on or after the effective date of the –2(k) regulations, followed by B's transfer of substantially all of old T's assets to new T, then, for all Federal income tax purposes, old T's liquidation into B and B's transfer of substantially all of old T's assets to new T will be disregarded and, instead, the transaction will be treated as if old T transferred substantially all of its assets to new T in exchange for new T stock in a reorganization described in section 368(a). This election is available only if a direct transfer of the old T assets to new T would qualify as a reorganization. Thus, S's gain from the sale of the T stock to B is not taken into account upon the liquidation of T but instead is taken into account with respect to the new T stock, the successor asset to the old T stock.

4. *Previous Intercompany Transaction With Respect to the T Stock.*

Under current §1.1502–13(f)(5) and these regulations, the election so described is available only if the old T stock had previously been transferred in an intercompany transaction. Comments are requested on whether the election should be available even when there has not been a previous intercompany transaction with respect to the old T stock.

5. *Effective/Applicability Date.*

The changes reflected in these temporary regulations (§1.1502–13T(f)(5)(ii)(B)(*1*) and (*2*)) generally apply to transactions in which T's liquidation into B occurs on or after the effective date of the –2(k) regulations, October 25, 2007. For transactions in which T's liquidation into B occurs before October 25, 2007, §1.1502–13(f)(5)(ii)(B)(*1*) and (*2*) in effect prior to October 25, 2007 as contained in 26 CFR part 1, revised April 1, 2009, continue to apply. Generally, pursuant to §1.1502–13T(f)(5)(ii)(B)(*2*) and §1.1502–13(f)(5)(ii)(E), the election described in these temporary regulations is made by entering into a written plan to transfer the T assets from B to new T on or before the due date of the consolidated tax return for the tax year that includes the date of the liquidation and including the statement described in §1.1502–13(f)(5)(ii)(E) on or with such timely filed return. However, consolidated groups for which the liquidation of the target corporation occurred on or after October 25, 2007, and whose tax return for the year of liquidation was filed before November 3, 2009 may make this election by entering into the written plan on or before November 3, 2009 and including the statement on or with an original tax return or an amended tax return for the tax year that includes the liquidation filed before November 3, 2009. In either case, the transfer of substantially all of T's assets to new T must be made within 12 months of the filing of such original or amended return.

Special Analyses

It has been determined that this temporary regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that these regulations will not have a significant impact on a substantial number of small entities. This certification is based on the fact that these regulations do not have a substantial economic impact because they merely provide for an election in the context of a taxpayer that has triggered deferred gain on subsidiary stock upon the liquidation of the subsidiary. Moreover, the regulations apply only to transactions involving consolidated groups which tend to be larger businesses. Accordingly a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these temporary regulations is Mary W. Lyons of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.1502–13T also issued under 26 U.S.C. 1502 * * *

Par. 2. Section 1.1502–13 is amended by revising paragraph (f)(5)(ii)(B) to read as follows:

§1.1502–13 Intercompany transactions.

* * * * *

(f) * * *

(5) * * *

(ii) * * *

(B)(*1*) [Reserved]. For further guidance, see §1.1502–13T(f)(5)(ii)(B)(*1*).

(*2*) [Reserved]. For further guidance, see §1.1502–13T(f)(5)(ii)(B)(*2*).

Par. 3. Section 1.1502–13T is amended by:

1. Revising paragraphs (f)(5)(ii)(B)(1), and (B)(2).

2. Adding paragraph (f)(5)(ii)(F).

The revisions and addition read as follows:

§1.1502–13T Intercompany transactions (temporary).

* * * * *

(c)(6)(ii)(D) through (f)(5)(ii)(A) [Reserved]. For further guidance, see §1.1502–13(c)(6)(ii)(D) through (f)(5)(ii)(A).

(B) *Section 332*—(*1*) *In general*. If section 332 would otherwise apply to T's (old T's) liquidation into B, and B transfers substantially all of old T's assets to a new member (new T), and if a direct transfer of substantially all of old T's assets to new T would qualify as a reorganization described in section 368(a), then, for all Federal income tax purposes, T's liquidation into B and B's transfer of substantially all of old T's assets to new T will be disregarded and instead, the transaction will be treated as if old T transferred substantially all of its assets to new T in exchange for new T stock and the assumption of T's liabilities in a reorganization described in section 368(a). (Under §1.1502–13(j)(1), B's stock in new T would be a successor asset to B's stock in old T, and S's gain would be taken into account based on the new T stock.)

(*2*) *Time limitation and adjustments*. The transfer of old T's assets to new T qualifies under paragraph (f)(5)(ii)(B)(*1*) of this section only if B has entered into a written plan, on or before the due date of the group's consolidated income tax return (including extensions), to transfer the T assets to new T, and the statement described in paragraph (f)(5)(ii)(E) of this section is included on or with a timely filed consolidated tax return for the tax year that includes the date of the liquidation (including extensions). However, see paragraph (f)(5)(ii)(F) of this section for certain situations in which the plan may be entered into after the due date of the return and the statement described in paragraph (f)(5)(ii)(E) of this section may be included on either an original tax return or an amended tax return filed after the due date of the return. In either case, the transfer of substantially all of T's assets to new T must be completed within 12 months of the filing of the return. Appropriate adjustments are made to reflect any events occurring before the formation of new T and to reflect any assets not transferred to new T, or liabilities not assumed by new T. For example, if B retains an asset of old T, the asset is treated under §1.1502–13(f)(3) as acquired by new T but distributed to B immediately after the reorganization.

(f)(5)(ii)(B)(*3*) through (f)(5)(ii)(E) [Reserved]. For further guidance, see §1.1502–13(f)(5)(ii)(B)(*3*) through (f)(5)(ii)(E).

(F) *Effective/Applicability date*—(*1*) *General rule*. Paragraphs (f)(5)(ii)(B)(*1*) and (*2*) of this section apply to transactions in which old T's liquidation into B occurs on or after October 25, 2007.

(*2*) *Prior periods*. For transactions in which old T's liquidation into B occurs before October 25, 2007, see §1.1502–13(f)(5)(ii)(B)(*1*) and (*2*) in effect prior to October 25, 2007 as contained in 26 CFR part 1, revised April 1, 2009.

(*3*) *Special rule for tax returns filed before November 3, 2009*. In the case of a liquidation on or after October 25, 2007, by a taxpayer whose original tax return for the year of liquidation was filed on or before November 3, 2009, then, notwithstanding paragraph (f)(5)(ii)(B)(*2*) of this section and §1.1502–13(f)(5)(ii)(E), the election to apply paragraph (f)(5)(ii)(B) of this section may be made by entering into the written plan described in paragraph (f)(5)(ii)(B) of this section on or before November 3, 2009, including the statement described in §1.1502–13(f)(5)(ii)(E) on or with an original tax return or an amended tax return for the tax year that includes the liquidation filed on or before November 3, 2009, and transferring substantially all of T's assets to new T within 12 months of the filing of such original or amended return.

(f)(6) through (f)(7)(i) *Example 6* [Reserved]. For further guidance, see §1.1502–13(f)(6) through (f)(7)(i) *Example 6*.

* * * * *

Part 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

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

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described		Current OMB control No.
* * * * *		
1.1502–13	....	1545–1433
* * * * *		

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

Approved August 27, 2009.

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

(Filed by the Office of the Federal Register on September 3, 2009, 8:45 a.m., and published in the issue of the Federal Register for September 4, 2009, 74 F.R. 45757)

Section 6229.—Period of Limitations for Making Assessments

26 CFR 301.6229(c)(2)–1T: Substantial omission of income (temporary).

T.D. 9466

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Definition of Omission from Gross Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulation.

SUMMARY: This document contains temporary regulations (replacing an existing final regulation) defining an omission from gross income for purposes of the six-year minimum period for assessment of tax attributable to partnership items and the six-year period for assessing tax. The temporary regulations resolve a continuing issue as to whether an overstatement of basis in a sold asset results in an omission from gross income. The regulations will affect any taxpayer who overstates basis in a sold asset creating an omission from gross income exceeding twenty-five percent of the income stated in the return. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective date:* These regulations are effective on September 24, 2009.

Applicability date: The rules of this section apply to taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009.

FOR FURTHER INFORMATION CONTACT: William A. Heard, III at (202) 622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

These temporary regulations amend the Procedure and Administration Regulations (26 CFR part 301) relating to sections 6229(c)(2) and 6501(e). Section 6229(c)(2) provides that if a partnership “omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated” in its return, the minimum period for assessing tax attributable to its partnership items is extended to six years. The quoted language is identical to language used in section 6501(e). An omission from gross income is not further defined in section 6229(c) as it is in section 6501(e)(1)(A). But, as noted by the courts, section 6229(c) merely serves to extend the section 6501 period for each separate partner to a minimum expiration date computed from the date the partnership return is filed or due to be filed, whichever is later. See section 6501(n)(2). In extending each partner’s section 6501 period under section 6229, Congress is presumed to give the language in section 6229, which is identical to language in section 6501, identical meaning. Having defined a phrase in section 6501, Congress need not redefine the same phrase when it is later used to extend that same statute of limitations. Ascribing a different interpretation to an identical phrase would result in partners being treated differently based on the happenstance of whether the transaction is reported on a partnership return rather than on a partner’s return. For instance, in Son of Boss transactions described in Notice 2000–44, 2000–2 C.B. 255 (Sept. 5, 2000), gross income can be generated by the partnership when it sells an inflated basis asset, or directly by the partner if the asset is first distributed to the partner before being sold. Thus, section 6501(e)(1)(A) defines an omission from gross income both for purposes of section 6501 and for any extension of section 6501 under section 6229. The temporary regulations confirm this point. Further, in light of the different interpretations given by courts to the meaning of section 6501(e)(1)(A), the temporary regulations clarify the meaning of this section. See §601.601(d)(2)(ii)(*b*).

Section 6501(e)(1)(A) provides that if the taxpayer omits from gross income an amount properly includible therein that is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. Subsection (i) of this provision provides that, in the case of a trade or business, the term *gross income* means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services.

These temporary regulations clarify that, outside of the trade or business context, gross income for purposes of sections 6501(e)(1)(A) and 6229(c)(2) has the same meaning as gross income as defined in section 61(a). Under section 61(a), gross income includes "gains derived from dealings in property" and the regulations under section 61(a) further explain that gain equals "the excess of the amount realized over the unrecovered cost or other basis for the property sold or exchanged." Accordingly, outside the context of a trade or business, any basis overstatement that leads to an understatement of gross income under section 61(a) constitutes an omission from gross income for purposes of sections 6501(e)(1)(A) and 6229(c)(2).

Relying on the Supreme Court's opinion in *Colony v. Commissioner*, 357 U.S. 28 (1958), which dealt with an omission from gross income in the context of a trade or business, the United States Courts of Appeals for the Ninth Circuit and Federal Circuit recently construed section 6501(e)(1)(A) in cases outside the trade or business context contrary to the interpretation provided in these temporary regulations, holding that an "omission" does not occur by an overstatement of basis. *Bakersfield Energy Partners v. Commissioner*, 568 F.3d 767 (9th Cir. 2009); *Salman Ranch Ltd v. United States*, 573 F.3d 1362 (Fed. Cir. 2009). The Treasury Department and the Internal Revenue Service disagree with these courts that the Supreme Court's reading of the predecessor to section 6501(e) in *Colony* applies to sections 6501(e)(1)(A) and 6229(c)(2). When Congress enacted the 1954 Internal Revenue Code, it was aware of the disagreement among the courts that existed at the time regarding the proper scope of section 275(c) of the 1939 Internal Revenue Code. The changes that Congress enacted as part of the 1954 Internal Revenue Code predated the Supreme Court's opinion in *Colony* and were intended to resolve the matter for the future. Therefore, by amending the Internal Revenue Code, including the addition of a special definition of "gross income" with respect to a trade or business, Congress effectively limited what ultimately became the holding in *Colony*, to cases subject to section 275(c) of the 1939 Internal Revenue Code. Moreover, under section 6501(e)(1)(A) of the 1954 Internal Revenue Code, which remains in effect under the 1986 Internal Revenue Code, when outside of the trade or business context, the definition of "gross income" in section 61 applies. In this regard, the Treasury Department and the Internal Revenue Service agree with the opinions in *Home Concrete & Supply, LLC v. United States*, 599 F.Supp.2d 678, 690 (E.D.N.C. 2008) (overstatement of basis can constitute an omission from gross income for purposes of the six-year period of limitations) and *Brandon Ridge Partners v. United States*, 2007–2 U.S.T.C. (CCH) ¶50,573, 100 A.F.T.R.2d (RIA) 5347, 5351–53 (M.D. Fla. 2007) (same).

Consistent with the Ninth Circuit's suggestion in *Bakersfield*, these temporary regulations clarify what constitutes an "omission from gross income" under sections 6501(e)(1)(A) and 6229(c)(2), as amended in connection with the enactment of the 1954 Internal Revenue Code and continuing in effect under the 1986 Internal Revenue Code. The reasonable interpretation of the provisions of sections 6501(e)(1)(A) and 6229(c)(2) provided in these temporary regulations, acknowledged by both the Ninth and Federal Circuits to be ambiguous, is entitled to deference even if the agency's interpretation may run contrary to the opinions in *Bakersfield* and *Salman Ranch*. See *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982–83 (2005); *Swallows Holding, Ltd. v. Commissioner*, 515 F.3d 162, 170 (3rd Cir. 2008). Because these temporary regulations are a clarification of the period of limitations provided in sections 6501(e)(1)(A) and 6229(c)(2) and are consistent with the Secretary's application of those provisions both with respect to a trade or business (that is, gross income means gross receipts), as well as outside of the trade or business context (that is, section 61 definition of gross income applies), they are applicable to all cases with respect to which the period for assessing tax under the applicable provisions has not expired before the date of filing of these regulations with the **Federal Register**.

Although these temporary regulations do not provide guidance on this issue, section 6501(e)(1)(A)(ii) additionally provides that the amount omitted from gross income does not include any amount disclosed on the return, or in a statement attached to the return, in a manner adequate to apprise the Internal Revenue Service of the nature and amount of the item. This adequate disclosure exception to the six-year statute of limitations applies to omissions from gross income resulting from basis overstatements (as provided for in these temporary regulations) in the same manner as it applies to other omissions from gross income. Accordingly, taxpayers who adequately disclose the nature and amount of the omissions from gross income resulting from dealings in property will not be subject to the extended six-year statute of limitations.

Special Analyses

It has been determined that these temporary regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble of the cross-reference notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is William A. Heard III of the Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR Part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding the entry in numerical order to read in part as follows:

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

Section 301.6229(c)(2)–1T is also issued under 26 U.S.C. §6230(k). * * *

Par. 2. Section 301.6229(c)(2)–1T is added to read as follows:

§301.6229(c)(2)–1T Substantial omission of income (temporary).

(a) *Partnership return*—(1) *General rule*. (i) If any partnership omits from the gross income stated in its return an amount properly includible therein that is in excess of 25 percent of the amount of gross income stated in its return, subsection (a) of section 6229 shall be applied by substituting "6 years" for "3 years."

(ii) For purposes of paragraph (a)(1)(i) of this section, the term *gross income*, as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of those goods or services.

(iii) For purposes of paragraph (a)(1)(i) of this section, the term *gross income*, as it relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, gross income means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6229(c)(2).

(iv) An amount shall not be considered as omitted from gross income if information sufficient to apprise the Commissioner of the nature and amount of the item is disclosed in the return, including any schedule or statement attached to the return.

(2) [Reserved].

(b) *Effective/applicability date*. The rules of this section apply to taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009.

(c) *Expiration date*. The applicability of this section expires on or before September 24, 2012.

§301.6501(e)–1 [Removed].

Par. 3. Section 301.6501(e)–1 is removed.

Par. 4. Section 301.6501(e)–1T is added to read as follows:

§301.6501(e)–1T Omission from return (temporary).

(a) *Income taxes*—(1) *General rule*. (i) If the taxpayer omits from the gross income stated in the return of a tax imposed by subtitle A of the Internal Revenue Code an amount properly includible therein that is in excess of 25 percent of the gross income so stated, the tax may be assessed, or a proceeding in court for the collection of that tax may be begun without assessment, at any time within 6 years after the return was filed.

(ii) For purposes of paragraph (a)(1)(i) of this section, the term *gross income*, as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of those goods or services.

(iii) For purposes of paragraph (a)(1)(i) of this section, the term *gross income*, as it relates to any income other than from the sale of goods or services in a trade or business, has the same meaning as provided under section 61(a), and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, *gross income* means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A).

(iv) An amount shall not be considered as omitted from gross income if information sufficient to apprise the Commissioner of the nature and amount of the item is disclosed in the return, including any schedule or statement attached to the return.

(2) [Reserved].

(b) *Effective/applicability date*. The rules of this section apply to taxable years with respect to which the applicable period for assessing tax did not expire before September 24, 2009.

(c) *Expiration date*. The applicability of this section expires on or before September 24, 2012.

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

Approved August 27, 2009.

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

(Filed by the Office of the Federal Register on September 3, 2009, 8:45 a.m., and published in the issue of the Federal Register for September 4, 2009, 74 F.R. 45757)

Part III. Administrative, Procedural, and Miscellaneous

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2009–76

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code as in effect for plan years beginning before 2008. It also provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), the 24-month average segment rates, and the funding transitional segment rates under § 430(h)(2). In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I), and the minimum present value segment rates under § 417(e)(3)(D) as in effect for plan years beginning after 2007.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006 (PPA), provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–2 C.B. 366.

The composite corporate bond rate for September 2009 is 5.79 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

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

For Plan Years Beginning in		Corporate Bond Weighted	Permissible Range		
Month	*Year*	Average	90%	to	100%
October	2009	6.46	5.82		6.46

YIELD CURVE AND SEGMENT RATES

Generally for plan years beginning after 2007 (except for delayed effective dates for certain plans under sections 104, 105, and 106 of PPA), § 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. For plan years beginning in 2008 and 2009, a transitional rule under § 430(h)(2)(G) provides that the segment rates are blended with the corporate bond weighted average as specified above. An election may be made under § 430(h)(2)(G)(iv) to use the segment rates without applying the transitional rule.

Notice 2007–81, 2007–2 C.B. 899, provides guidelines for determining the monthly corporate bond yield curve, the 24-month average corporate bond segment rates, and the funding transitional segment rates used to compute the target normal cost and the funding target. Pursuant to Notice 2007–81, the monthly corporate bond yield curve derived from September 2009 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of September 2009 are, respectively, 2.73, 5.63, and 6.07. The three 24-month average corporate bond segment rates applicable for October 2009 under the election of § 430(h)(2)(G)(iv) are as follows:

First Segment	Second Segment	Third Segment
4.92	6.71	6.80

The transitional segment rates under § 430(h)(2)(G) applicable for October 2009, taking into account the corporate bond weighted average of 6.46 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.95	6.54	6.57
2009	5.43	6.63	6.69

The transitional rule of § 430(h)(2)(G) does not apply to plan years starting in 2010. Therefore, for a plan year starting in 2010 with a lookback month to October 2009, the funding segment rates are the three 24-month average corporate bond segment rates applicable for October 2009, listed above without blending for the transitional period.

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 417(e)(3)(A)(ii)(II) (prior to amendment by PPA) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual rate of interest on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for September 2009 is 4.19 percent. The Service has determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in August 2039.

Generally for plan years beginning after 2007, § 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in section 431(c)(6)(A), based on the plan's current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88–73, 1988–2 C.B. 383, provides guidelines for determining the weighted average interest rate. The following rates were determined for plan years beginning in the month shown below.

For Plan Years Beginning in		30-Year Treasury Weighted	Permissible Range	
Month	*Year*	Average	90% to	105%
October	2009	4.38	3.94	4.59

MINIMUM PRESENT VALUE SEGMENT RATES

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. For plan years beginning in 2008 through 2011, the applicable interest rates are the monthly spot segment rates blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for September 2009, taking into account the September 2009 30-year Treasury rate of 4.19 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	3.90	4.48	4.57
2009	3.61	4.77	4.94
2010	3.31	5.05	5.32

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

Table I

Monthly Yield Curve for September 2009

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	1.24	20.5	6.06	40.5	6.08	60.5	6.09	80.5	6.10
1.0	1.60	21.0	6.06	41.0	6.08	61.0	6.09	81.0	6.10
1.5	1.96	21.5	6.06	41.5	6.08	61.5	6.09	81.5	6.10
2.0	2.31	22.0	6.06	42.0	6.08	62.0	6.09	82.0	6.10
2.5	2.64	22.5	6.06	42.5	6.08	62.5	6.09	82.5	6.10
3.0	2.95	23.0	6.06	43.0	6.08	63.0	6.09	83.0	6.10
3.5	3.25	23.5	6.06	43.5	6.08	63.5	6.09	83.5	6.10
4.0	3.52	24.0	6.06	44.0	6.08	64.0	6.09	84.0	6.10
4.5	3.78	24.5	6.06	44.5	6.08	64.5	6.09	84.5	6.10
5.0	4.02	25.0	6.06	45.0	6.08	65.0	6.09	85.0	6.10
5.5	4.24	25.5	6.06	45.5	6.08	65.5	6.09	85.5	6.10
6.0	4.44	26.0	6.06	46.0	6.08	66.0	6.09	86.0	6.10
6.5	4.63	26.5	6.06	46.5	6.08	66.5	6.09	86.5	6.10
7.0	4.80	27.0	6.06	47.0	6.08	67.0	6.09	87.0	6.10
7.5	4.96	27.5	6.06	47.5	6.08	67.5	6.09	87.5	6.10
8.0	5.10	28.0	6.06	48.0	6.08	68.0	6.09	88.0	6.10
8.5	5.23	28.5	6.06	48.5	6.08	68.5	6.09	88.5	6.10
9.0	5.34	29.0	6.06	49.0	6.08	69.0	6.09	89.0	6.10
9.5	5.45	29.5	6.06	49.5	6.08	69.5	6.09	89.5	6.10
10.0	5.54	30.0	6.06	50.0	6.08	70.0	6.09	90.0	6.10
10.5	5.62	30.5	6.06	50.5	6.08	70.5	6.09	90.5	6.10
11.0	5.69	31.0	6.06	51.0	6.08	71.0	6.09	91.0	6.10
11.5	5.76	31.5	6.06	51.5	6.08	71.5	6.09	91.5	6.10
12.0	5.81	32.0	6.06	52.0	6.08	72.0	6.09	92.0	6.10
12.5	5.86	32.5	6.07	52.5	6.08	72.5	6.09	92.5	6.10
13.0	5.90	33.0	6.07	53.0	6.08	73.0	6.09	93.0	6.10
13.5	5.94	33.5	6.07	53.5	6.09	73.5	6.09	93.5	6.10
14.0	5.96	34.0	6.07	54.0	6.09	74.0	6.09	94.0	6.10
14.5	5.99	34.5	6.07	54.5	6.09	74.5	6.09	94.5	6.10
15.0	6.01	35.0	6.07	55.0	6.09	75.0	6.09	95.0	6.10
15.5	6.02	35.5	6.07	55.5	6.09	75.5	6.09	95.5	6.10
16.0	6.03	36.0	6.07	56.0	6.09	76.0	6.09	96.0	6.10
16.5	6.04	36.5	6.07	56.5	6.09	76.5	6.09	96.5	6.10
17.0	6.05	37.0	6.07	57.0	6.09	77.0	6.09	97.0	6.10
17.5	6.06	37.5	6.07	57.5	6.09	77.5	6.09	97.5	6.10
18.0	6.06	38.0	6.07	58.0	6.09	78.0	6.09	98.0	6.10
18.5	6.06	38.5	6.07	58.5	6.09	78.5	6.10	98.5	6.10
19.0	6.06	39.0	6.07	59.0	6.09	79.0	6.10	99.0	6.10
19.5	6.06	39.5	6.07	59.5	6.09	79.5	6.10	99.5	6.10
20.0	6.06	40.0	6.07	60.0	6.09	80.0	6.10	100.0	6.10

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Definition of Omission from Gross Income

REG–108045–08

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document contains proposed regulations defining an omission from gross income for purposes of the six-year minimum period for assessment of tax attributable to partnership items and the six-year period for assessing tax. The regulations resolve a continuing issue as to whether an overstatement of basis in a sold asset results in an omission from gross income. The regulations will affect any taxpayer who overstates basis in a sold asset creating an omission from gross income exceeding twenty-five percent of the income stated in the return. The text of the temporary regulations (T.D. 9466) published in this issue of the Bulletin also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed and temporary regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by December 28, 2009.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–108045–08), room 5205, Internal Revenue Service, P.O. 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–108045–08), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–108045–08).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, William A. Heard, III at (202) 622–4570; concerning submissions of comments and requests for a public hearing, *Richard.A.Hurst@irscounsel.treas.gov*, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Procedure and Administration Regulations (26 CFR part 301) relating to sections 6229(c)(2) and 6501(e). The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

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

Comments and Requests 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 substance of the proposed regulations, as well as on the clarity of the proposed rules and how they can be made easier to understand. All public comments will be made available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that 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 regulations is William A. Heard III of the Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding the entry in numerical order to read in part as follows:

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

Section 301.6229(c)(2)–1 is also issued under 26 U.S.C. §6230(k). * * *

Par. 2. Section 301.6229(c)(2)–1 is added to read as follows:

§301.6229(c)(2)–1 Substantial omission of income.

[The text of §301.6229(c)(2)–1 is the same as the text of §301.6229(c)(2)–1T published elsewhere in the Bulletin].

Par. 3. Section 301.6501(e)–1 is added to read as follows:

§301.6501(e)–1 Omission from return.

[The text of §301.6501(e)–1 is the same as the text of §301.6501(e)–1T published elsewhere in the Bulletin].

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

(Filed by the Office of the Federal Register on September 24, 2009, 4:15 p.m., and published in the issue of the Federal Register for September 28, 2009, 74 F.R. 46345)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Modification to Consolidated Return Regulation Permitting an Election to Treat a Liquidation of a Target, Followed by a Recontribution to a New Target, as a Cross-Chain Reorganization

REG–139068–08

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9458) under section 1502 of the Internal Revenue Code (Code). The temporary regulations modify the election under which a consolidated group can avoid immediately taking into account an intercompany item after the liquidation of a target corporation. This modification was made necessary in light of the regulations under section 368 that were issued in October 2007 addressing transfers of assets or stock following a reorganization. The temporary regulations apply to corporations filing consolidated returns. The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written comments and requests for a public hearing must be received by December 2, 2009.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–139068–08), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday to CC:PA:LPD:PR (REG–139068–08), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–139068–08).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Mary W. Lyons, (202) 622–7930; concerning submission of comments and the hearing, Oluwafunmilayo (Funmi) Taylor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by December 3, 2009. Comments are specifically requested concerning:

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

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

How the quality, utility, and clarity of the information to be collected may be enhanced;

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

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

The collection of information in this proposed regulation is in §1.1502–13(f)(5)(ii)(E) as contained in 26 CFR part 1, revised April 1, 2009, and proposed §1.1502–13(f)(5)(ii)(B)(*2*). This information is required by the IRS to allow certain parties to make an election to apply §1.1502–13(f)(5)(ii)(B). The likely recordkeepers are corporations filing consolidated income tax returns. No additional burden is anticipated with respect to these proposed regulations over that already required in the regulations currently in effect (CO–11–91 Final and CO–24–95 Final).

Estimated total annual reporting burden: 100 hours.

Estimated average annual burden hours per respondent: 2 hours.

Estimated number of respondents: 50.

Estimated annual frequency of responses: Once.

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

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

Background

The temporary regulations published in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) under section 1502. The temporary regulations provide that if the election to apply §1.1502–13(f)(5)(ii)(B) is made for a transaction in which old T liquidates into B on or after the effective date of the regulations under §1.368–2(k), issued in October 2007, followed by B's transfer of substantially all of old T's assets to new T, then, for all Federal income tax purposes, old T's liquidation into B and B's transfer of substantially all of old T's assets to new T will be disregarded and, instead, the transaction will be treated as if old T transferred substantially all of its assets to new T in exchange for new T stock in a reorganization described in section 368(a). This election is available only if a direct transfer of the old T assets to new T would qualify as a reorganization. Thus, S's gain from the sale of the T stock to B is not taken into account upon the liquidation of T but instead is taken into account with respect to the new T stock, the successor asset to the old T stock.

The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the reasons for the modifications to the final regulations contained in the temporary regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Further, it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations do not have a substantial economic impact because they merely provide for an election in the context of a taxpayer that has triggered deferred gain on subsidiary stock upon the liquidation of the subsidiary. Moreover, the regulations apply only to transactions involving consolidated groups which tend to be larger businesses. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

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

Drafting Information

The principal author of these proposed regulations is Mary W. Lyons of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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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 1.1502–13 also issued under 26 U.S.C. 1502 * * *

Par. 2. Section 1.1502–13 is amended by revising paragraphs (f)(5)(ii)(B) and adding paragraph (f)(5)(ii)(F) to read as follows:

§1.1502–13 Intercompany transactions.

* * * * *

(f) * * *

(5) * * *

(ii) * * *

(B)(1) [The text of the proposed amendments to §1.1502–13(f)(5)(ii)(B)(*1*) is the same as the text of §1.1502–13T(f)(5)(ii)(B)(*1*) published elsewhere in this issue of the Bulletin].

(2) [The text of the proposed amendments to §1.1502–13(f)(5)(ii)(B)(*2*) is the same as the text of §1.1502–13T(f)(5)(ii)(B)(*2*) published elsewhere in this issue of the Bulletin].

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(F) [The text of the proposed amendments to §1.1502–13(f)(5)(ii)(F) is the same as the text of §1.1502–13T(f)(5)(ii)(F) published elsewhere in this issue of the Bulletin].

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

(Filed by the Office of the Federal Register on September 3, 2009, 8:45 a.m., and published in the issue of the Federal Register for September 4, 2009, F.R. 45789)

Definition of Solid Waste Disposal Facilities for Tax-exempt Bond Purposes

REG–140492–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking; Notice of proposed rulemaking; Notice of public hearing on proposed rulemaking.

SUMMARY: This document contains proposed regulations on the definition of solid waste disposal facilities for purposes of the rules applicable to tax-exempt bonds issued by State and local governments. These proposed regulations provide guidance to State and local governments that issue tax-exempt bonds to finance solid waste disposal facilities and to taxpayers that use those facilities. This document also withdraws the notice of proposed rulemaking that was published in the **Federal Register** on May 10, 2004 (REG–140492–02, 2004–1 C.B. 1031 [69 FR 25856]), proposes to remove certain existing regulations that provide rules for determining whether a facility is a solid waste disposal facility, and contains a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 15, 2009. Outlines of topics to be discussed at the public hearing scheduled for January 5, 2010 must be received by December 17, 2009.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–140492–02), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–140492–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–140492–02). The public hearing will be held in room 2615 at the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Aviva Roth at (202) 622–3980; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, e-mail *Richard.A.Hurst@irscousel.treas.gov*.

SUPPLEMENTARY INFORMATION:

Background

This document proposes to amend the Income Tax Regulations (26 CFR part 1) under section 142 of the Internal Revenue Code (Code) to provide rules for determining whether a facility is a solid waste disposal facility under section 142(a)(6). This document also proposes to remove certain existing regulations that provide rules for determining whether a facility is a solid waste disposal facility and contains a notice of public hearing on these proposed regulations. On May 10, 2004, the IRS published a notice of proposed rulemaking (REG–140492–02) in the **Federal Register** (69 FR 25856) regarding when a facility qualifies as a solid waste disposal facility under section 142 (2004 Proposed Regulations). The 2004 Proposed Regulations proposed a new §1.142(a)(6)–1 of the Income Tax Regulations and would have removed existing §1.103–8(f)(2) and §17.1 of the temporary Income Tax Regulations on this subject (together, the Existing Regulations). Comments on the 2004 Proposed Regulations were received and a hearing was held on August 11, 2004. After consideration of the public comments, the IRS and the Treasury Department propose extensive changes to the 2004 Proposed Regulations. In order to allow the public an opportunity to comment with respect to these extensive changes, we are issuing these proposed regulations and holding a public hearing on these proposed regulations.

Explanation of Provisions

1. *Introduction and Existing Regulations*.

In general, interest on State or local bonds is excludable from gross income under section 103(a). Under section 103(b), however, interest on private activity bond is excludable from gross income under section 103 only if the bond meets the requirements for a qualified bond under section 141(e) and other applicable requirements under section 103. Section 141(e) defines a qualified bond to include an exempt facility bond that meets certain requirements. Section 142(a) defines an exempt facility bond to mean any bond that is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide an exempt facility specified in section 142(a). Section 142(a)(6) includes a solid waste disposal facility as one specified type of qualified exempt facility.

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

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

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

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

Section 17.1(a) of the Existing Regulations generally provides that, for mixed-use facilities that serve a solid waste disposal function and other functions, only the portion of the cost of the property allocable to the function of solid waste disposal qualifies as an eligible cost of a solid waste disposal facility. Section 17.1(a) of the Existing Regulations further provides that a facility that otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid waste disposal merely because material or heat that has utility or value is recovered or results from the disposal process. Section 17.1(a) of the Existing Regulations provides that, when materials or heat are recovered, the waste disposal function includes the processing of those materials or heat that occurs in order to put them into the form in which the materials or heat are in fact sold or used, but does not include further processing that converts the materials or heat into other products.

Section 17.1(b) of the Existing Regulations provides that the portion of the cost of property allocable to solid waste disposal is determined by allocating the cost of the property between the property's solid waste disposal function and any other functions by any method that reasonably reflects a separation of costs for each function of the property, based on the facts and circumstances.

2. *The 2004 Proposed Regulations*.

In light of the changes that have occurred in the waste recycling industry since the Existing Regulations were issued in the 1970's, the IRS and the Treasury Department issued Notice 2002–51, 2002–2

C.B. 131, which invited comments on issues concerning the application of section 142 to solid waste disposal facilities, including recycling facilities. After consideration of the public comments on the Notice, the IRS and the Treasury Department issued the 2004 Proposed Regulations. See §601.601(d)(2)(ii)(b).

The 2004 Proposed Regulations proposed to eliminate the No-Value Test for determining whether material is solid waste. Instead, the 2004 Proposed Regulations, retaining the definition of solid waste under former section 203(4) of the Solid Waste Disposal Act, provided that "garbage, refuse and other discarded solid materials" meant material that is solid and that is introduced into a final disposal process, conversion process, recovery process, or transformation process (as those terms were defined in the 2004 Proposed Regulations) unless such material fell within one of several categories of specifically excluded items. Included within the categories of specifically excluded items under the 2004 Proposed Regulations were: (1) fossil fuels or other materials created for the principal purpose of converting the materials to heat, hot water, steam, or other useful energy, introduced into a conversion process; (2) precious metals introduced into a recovery process; (3) hazardous materials subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on October, 22, 1986, the date of enactment of the Tax Reform Act of 1986); and (4) radioactive materials.

The 2004 Proposed Regulations provided that a facility is a solid waste disposal facility to the extent that the facility is: (1) used to perform a solid waste disposal function, (2) used to perform a preliminary function, or (3) functionally related and subordinate (within the meaning of §1.103–8(a)(3)) to a facility that is used to perform a solid waste disposal function or a preliminary function.

The 2004 Proposed Regulations further defined a solid waste disposal function as the processing of solid waste in (1) a final disposal process, (2) a conversion process, (3) a recovery process, or (4) a transformation process. A final disposal process was defined as the placement of material in a landfill or the incineration of material without any useful energy being captured. A conversion process was defined as a process in which material is incinerated and heat, hot water, or steam is created and captured as useful energy beginning with the incineration of material and ending at the point at which the latest of heat, hot water, or steam is created. A recovery process was defined as a process that starts with the melting or re-pulping of material to return the material to a form in which the material previously existed for use in the fabrication of an end product and ends immediately before the material is processed in the same or substantially the same way that virgin material is processed to fabricate the end product. With respect to such definition of recovery process, the 2004 Proposed Regulations further provided that if an end product is fabricated entirely from non-virgin material, the recovery process ends immediately before the non-virgin material is processed in the same or substantially the same way that virgin material is processed in a comparable fabrication process that uses only virgin material or a combination of virgin and non-virgin material. According to the 2004 Proposed Regulations, refurbishing, repair, or similar activities are not recovery processes. The IRS and Treasury Department reserved on the definition of transformation process.

The 2004 Proposed Regulations provided that a preliminary function is the collection, separation, sorting, storage, treatment, processing, disassembly, or handling of solid material that is preliminary and directly related to a solid waste disposal function unless for each year while the issue is outstanding, more than 50 percent, by weight or volume, of the total materials that result from the entire activity (both the part that is preliminary and directly related to a solid waste disposal function and the part that is not preliminary and directly related to a solid waste disposal function) is solid waste.

The 2004 Proposed Regulations further provided that if a facility is used to perform both (1) a solid waste disposal function or a preliminary function, and (2) another function, then the costs of the facility allocable to the solid waste disposal function or the preliminary function are determined using any reasonable method, based on all the facts and circumstances. This rule applies, for example, if a facility is used (1) to process solid waste in a recovery process, and (2) to perform another function that is neither a solid waste disposal function (because it does not process solid waste in a final disposal process, conversion process, recovery process, or transformation process) nor a preliminary function (because it is not preliminary and directly related to a solid waste disposal function). The 2004 Proposed Regulations also contained a special rule to determine the portion of the costs of property that are allocable to a solid waste disposal function if the property is used to perform a final disposal process, conversion process, recovery process, or transformation process and the inputs to the process consist of solid waste and material that is not solid waste. Under this special rule, the portion of the costs of property used to perform such a process that are allocable to a solid waste disposal function equals the lowest percentage of solid waste processed in the process in any year while the issue is outstanding. The percentage of solid waste processed in such a process for any year is the percentage, by weight or volume, of the total materials processed in the process that constitute solid waste for that year. If, however, for each year while the issue is outstanding, solid waste constitutes at least 80 percent, by weight or volume, of the total materials processed in the process, all of the costs of the property used to perform the process are allocable to a solid waste disposal function.

3. *Comments on the 2004 Proposed Regulations*.

In response to the 2004 Proposed Regulation, comments were received with respect to the definition of solid waste. Some commentators criticized the elimination of the No-Value Test from the definition of solid waste in the 2004 Proposed Regulations, while other commentators agreed with the deletion of the No-Value Test. Commentators suggested various changes to the proposed definition of solid waste. Other commentators suggested clarification that community waste qualifies as solid waste.

Comments also were received with respect to categories of items specifically excluded from the definition of solid waste under the 2004 Proposed Regulations. Some commentators suggested that the exclusion from solid waste for fossil fuels that are introduced into an energy conversion process is too broad because it excludes fossil fuels that are low-grade, such as waste coal that is not grown, harvested, produced, mined, or otherwise created for the principal purpose of converting material to useful energy. Other commentators suggested that solid waste introduced into an energy conversion process should include certain byproducts of typical agricultural operations that are not engaged in with the principal purpose of growing, harvesting, producing, or otherwise creating products to convert such products into useful energy. Commentators further suggested clarification of the exclusion from the definition of solid waste for precious metals introduced to a recycling process. Still other commentators further suggested the inclusion of hazardous waste and radioactive waste as solid waste.

Comments were received with respect to the various solid waste disposal processes. With respect to the final disposal process, some commentators suggested the inclusion of indefinite confinement of material within a final disposal process. With respect to the energy conversion process, commentators suggested including methods of creating energy besides combustion within an energy conversion process and expanding the scope of an eligible energy conversion process to include certain related processes. Another comment suggested disregarding small amounts of otherwise-ineligible fossil fuels and chemical and other additives.

Comments also were received with respect to mixed-input facilities that receive both solid waste material and other types of input. Commentators suggested an expansion of the scope of permitted mixed-input facilities to include an allowable amount of 35 percent or less of material that is not solid waste to be introduced to an energy conversion process or a recycling process without disqualifying those processes. Commentators also suggested measuring the allowable amount of non-solid waste input into a mixed-input facility based on the average percentage of inputs that are not solid waste over the life of the issue.

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

4. *Regulations Proposed in This Document*.

A. *Solid waste disposal facility*.

The proposed regulations define a solid waste disposal facility as any facility to the extent that it (1) processes solid waste in a qualified solid waste disposal process, (2) performs a preliminary function, or (3) is functionally related and subordinate (within the meaning of §1.103–8(a)(3)) to a facility which either processes solid waste in a qualified solid waste disposal process or performs a preliminary function.

B. *Definition of solid waste*.

The proposed regulations eliminate the No-Value Test, as did the 2004 Regulations. The IRS and the Treasury Department have determined that whether material has value, or value apart from recycling as one commentator suggested, is unadministrable. However, in response to the comments received with respect to the 2004 Proposed Regulations, the IRS and the Treasury Department have determined that a definition of solid waste is needed that takes into account the material itself and not only the process by which such material is to be disposed or recycled. Accordingly, the proposed regulations define solid waste as garbage, refuse, and other solid material, derived from any agricultural, commercial, consumer, or industrial operation or activity that is either used material or residual material and that is reasonably expected by the person who purchases or otherwise acquires such material to be introduced within a reasonable time after such purchase or acquisition in a qualified solid waste disposal process. While the type of disposal or recycling process does not affect the treatment of material as solid waste, the person acquiring such material must intend to place such materials into a qualified solid waste disposal process within a reasonable time after acquisition. Material that the acquiring party intends to store or resell to the general public is not solid waste under the proposed regulations.

Used material is defined in the proposed regulations as any material that has been used previously as an agricultural, commercial, consumer, or industrial product or as a component of any such product. It is the intention of the IRS and Treasury Department that this definition be interpreted broadly to encompass popularly understood uses of materials but that such definition should not apply to smaller products purchased by manufacturers and incorporated by such manufacturer into a larger product.

Residual material is defined in the proposed regulations as any residual byproduct or excess unused raw material that remains from the production of any agricultural, commercial, consumer, or industrial product, provided that material qualifies as residual material only to the extent that it constitutes less than five percent of the total material introduced into the production process and it has a fair market value that is reasonably expected to be lower than that of any product made in that production process. This definition is intended to encompass a wide range of products from waste coal to byproducts of typical agricultural operations, and is intended to further encourage innovation in the full use of all resources.

C. *Specific exclusions from the definition of solid waste*.

The proposed regulations exclude from the definition of solid waste the following items: (1) virgin material; (2) solids within liquids and liquid waste; (3) precious metals; (4) hazardous material; and (5) radioactive material. The definition of virgin material in the proposed regulations encompasses all raw materials except to the extent such material becomes remainder material. The proposed regulations further clarify that a material does not cease to be virgin material until it has been processed to a point where no further processing is expected.

The proposed regulations specifically exclude certain commonly-recognized precious metals from the definition of solid waste because recovery of these metals generally would take place with or without a recycling industry.

With respect to hazardous and radioactive waste, the statute and legislative history suggest that Congress intended to exclude hazardous waste and radioactive waste from solid waste. The statute treats qualified hazardous waste facilities separately as eligible exempt facilities under section 142(a)(10) in addition to solid waste disposal facilities under section 142(a)(6). In addition, the legislative history provides, in relevant part, that "the conferees wish to clarify that solid waste does not include most hazardous waste (including radioactive waste)." H.Rep. No. 99–841, 99th Cong. 2d. Sess (September 18, 1986), 1986–3 C.B. Vol. 4, at II–704. Accordingly, such items are specifically excluded from the definition of solid waste.

D. *Qualified solid waste disposal process*.

The proposed regulations provide for three eligible types of solid waste disposal processes, including a final disposal process, an energy conversion process, and a recycling process. In order to provide flexibility for future innovation, absent an express restriction in the proposed regulations, a solid waste disposal function may employ any biological, engineering, industrial, or technological method.

Under the proposed regulations, a final disposal process includes the placement of solid waste in a landfill, the incineration of solid waste without capturing any useful energy, and the containment of solid waste with the reasonable expectation that the containment will continue indefinitely and that the solid waste has no current or future beneficial use.

To accommodate existing and new technologies, the description of an energy conversion process in the proposed regulations includes thermal, chemical, and other processes used to create and capture useful energy. The proposed regulations also permit 35 percent or less of the material introduced to an energy conversion process to be material other than solid waste to accommodate disposal processes that require the introduction of materials other than solid waste. In general, under the proposed regulations, an energy conversion process begins at the point of the first application of a process to create and capture useful energy and ends at the point at which the useful energy is first created or captured in the form of a first useful product (for example, the conversion of solid waste into useful steam energy). The proposed regulations generally do not include related processes in an energy conversion process because these processes are appropriately included in preliminary facilities and functionally related and subordinate functions.

In response to public comment and in further consideration of policy in support of recycling, the proposed regulations combine the concepts of recovery process and transformation process introduced in the 2004 Proposed Regulations into an eligible recycling process, which means a process for disposing of solid waste that reconstitutes, transforms, or otherwise processes the solid waste into a useful product. The recycling process begins at the point of the first application of a process to reconstitute or transform the solid waste into a useful product, such as decontamination, melting, re-pulping, shredding, or other processing of the solid waste to accomplish this purpose. The recycling process ends at the point of completion of production of the first useful product from the solid waste.

E. *First useful product principle*.

The proposed regulations provide guidance on the standard for determining the first useful product for purposes of the end point of an eligible energy conversion process and recycling process. For this purpose, the proposed regulations provide that the term useful product means a product that is useful for consumption in individual, commercial, industrial, or agricultural use and that could be sold for such use, whether or not actually sold. For this purpose, a useful product includes both a product useful to an individual or commercial consumer as an ultimate end-use product and a product useful to an industrial user as a material or input for processing in some stage of a manufacturing or production process to produce a different end-use product. Further, for this purpose, in the case of a continuous or integrated production process, the determination of when a useful product may result from such an integrated process may take into account operational constraints that affect the point in production when a useful product reasonably can be extracted or isolated and sold independently.

F. *Mixed-input facilities*.

The proposed regulations expand the scope of permitted mixed-input facilities to include an allowable amount of 35 percent or less of material that is not solid waste to be introduced each year into an energy conversion process or a recycling process without disqualifying those processes.

Proposed Effective Dates

In general, the proposed regulations will apply to bonds to which section 142 applies that are sold on or after the date that is 60 days after the date of publication of final regulations under section 142(a)(6) in the **Federal Register**. Issuers may apply this section to bonds sold before the date that is 60 days after publication of final regulations in the **Federal Register**.

Special Analysis

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

Comments and Public Hearing

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

A public hearing has been scheduled for January 5, 2010 beginning at 10:00 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by December 17, 2009. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations are Aviva M. Roth and Timothy L. Jones, Office of the Associate Chief Counsel (Financial Institutions and Products), Internal Revenue Service. However, personnel from other offices of the Treasury Department and the IRS participated in their development.

Withdrawal of Previous Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG–140492–02) that was published in the **Federal Register** on May 10, 2004 (69 FR 25856), is withdrawn as of September 16, 2009.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.103–8 is amended by removing paragraph (f)(2)(ii) and redesignating paragraph (f)(2)(iii) as (f)(2)(ii)

§1.103–8[Amended].

Par. 3. Section 1.142(a)(6)–1 is added to read as follows:

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

(a) *In general.* This section defines the term solid waste disposal facility for purposes of section 142(a)(6).

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

(1) Processes solid waste (as defined in paragraph (c) of this section) in a qualified solid waste disposal process (as defined in paragraph (d) of this section);

(2) Performs a preliminary function (as defined in paragraph (f) of this section); or

(3) Is functionally related and subordinate (within the meaning of §1.103–8(a)(3)) to a facility described in paragraph (1) or (2) of this section.

(c) *Solid waste*—(1) *In general.*Except to the extent excluded under paragraph (c)(2) of this section, for purposes of section 142(a)(6), the term *solid waste* means garbage, refuse, and other solid material derived from any agricultural, commercial, consumer, or industrial operation or activity if the material meets the requirements of both paragraph (c)(1)(i) and paragraph (c)(1)(ii) of this section.

(i) *Used material or residual material.* Material meets the requirements of this paragraph (c)(1) if it is either used material (as defined in paragraph (c)(1)(i)(A)) or residual material (as defined in paragraph(c)(1)(i)(B)).

(A) *Used material.* The term *used material* means any material that has been used previously as an agricultural, commercial, consumer or industrial product or as a component of any such product.

(B) *Residual material.* The term *residual material* means any residual byproduct or excess unused raw material that remains from the production of any agricultural, commercial, consumer, or industrial product, provided that material qualifies as residual material only to the extent that it constitutes less than five percent of the total material introduced into the production process and it has a fair market value that is reasonably expected to be lower than that of any product made in that production process.

(ii) *Reasonably expected introduction into a qualified solid waste disposal process.* Material meets the requirements of this paragraph (c)(1)(ii) if it is reasonably expected by the person who purchases or otherwise acquires it to be introduced within a reasonable time after such purchase or acquisition into a qualified solid waste disposal process described in paragraph (d) of this section.

(2) *Exclusions from solid waste.* The following materials do not constitute solid waste:

(i) *Virgin material.* Solid waste excludes any virgin material except to the extent that it is a residual material. The term *virgin material* means material that has not been processed into an agricultural, commercial, consumer, or industrial product or a component of any such product. Further, for this purpose, material continues to be virgin material after it has been grown, harvested, mined, or otherwise extracted from its naturally occurring location and cleaned, divided into component elements, modified, or enhanced as long as further processing is required before it becomes an agricultural, commercial, consumer, or industrial product or a component of any such product.

(ii) *Solids within liquids and liquid waste.* Solid waste excludes any solid or dissolved material in domestic sewage or other significant pollutant in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows or other common water pollutants, and liquid or gaseous waste.

(iii) *Precious metals.* Solid waste excludes gold, silver, ruthenium, rhodium, palladium, osmium, iridium, platinum, gallium, and rhenium.

(iv) *Hazardous material.* Solid waste excludes any hazardous material that is disposed of at a facility that is subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act as in effect on the date of the enactment of the Tax Reform Act of 1986 (which is October 22, 1986). See section 142(h)(1) of the Internal Revenue Code.

(v) *Radioactive material.* Solid waste excludes any radioactive material.

(d) *Qualified solid waste disposal process.* The term *qualified solid waste disposal process* means the processing of solid waste in a final disposal process (as defined in paragraph (d)(1) of this section), an energy conversion process (as defined in paragraph (d)(2) of this section), or a recycling process (as defined in paragraph (d)(3) of this section). Absent an express restriction to the contrary in this section, a qualified solid waste disposal process may employ any biological, engineering, industrial, or technological method.

(1) *Final disposal process*. The term *final disposal process* means either the placement of solid waste in a landfill, the incineration of solid waste without capturing any useful energy, or the containment of solid waste with a reasonable expectation that the containment will continue indefinitely and that the solid waste has no current or future beneficial use.

(2) *Energy conversion process*. The term *energy conversion process* means a thermal, chemical, or other process that is applied to solid waste to create and capture synthesis gas, heat, hot water, steam, or other useful energy. The energy conversion process begins at the point of the first application of such process. The energy conversion process ends at the point at which the useful energy is first created or captured in the form of a first useful product (as defined in paragraph (e) of this section), provided that, in all events, the energy conversion process ends before any transfer or distribution of synthesis gas, heat, hot water, steam, or other useful energy.

(3) *Recycling process*—(i) *In general*. The term *recycling process* means reconstituting, transforming, or otherwise processing solid waste into a useful product. The recycling process begins at the point of the first application of a process to reconstitute or transform the solid waste into a useful product, such as decontamination, melting, re-pulping, shredding, or other processing of the solid waste to accomplish this purpose. The recycling process ends at the point of completion of production of the first useful product from the solid waste.

(ii) *Refurbishment, repair, or similar activities*. The term recycling process does not include refurbishment, repair, or similar activities. The term *refurbishment* means the breakdown and reassembly of a product if such activity is done on a product by product basis and if the finished product contains more than 30 percent of its original materials or components.

(e) *First useful product*. The term *first useful product* means the first product produced from solid waste that is useful for consumption in agricultural, consumer, commercial, or industrial operation or activity and that could be sold for such use, whether or not actually sold. A useful product includes both a product useful to an individual consumer as an ultimate end-use consumer product and a product useful to an industrial user as a material or input for processing in some stage of a manufacturing or production process to produce a different end-use consumer product. In the case of a continuous or integrated production process, the determination of when a useful product may result from such an integrated process may take into account operational constraints that affect the point in production when a useful product reasonably can be extracted or isolated and sold independently.

(f) *Preliminary function*. A preliminary function is a function to collect, separate, sort, store, treat, process, disassemble, or handle solid waste that is preliminary to and directly related to a qualified solid waste disposal process. A function qualifies as a preliminary function only if more than 50 percent of the total materials that result from the function is solid waste in each year that the issue is outstanding.

(g) *Mixed-use facilities*—(1) *In general*. Except as otherwise provided in paragraph (g)(2) of this section, if a facility is used for both a qualified solid waste disposal function (including a qualified solid waste disposal process or a preliminary function) and a nonqualified function, then the costs of the facility allocable to the qualified solid waste disposal function are determined using any reasonable method, based on all the facts and circumstances. See §1.103–8(a)(1) for allocation rules on amounts properly allocable to an exempt facility.

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

(ii) *Special rule for mixed-input processes if at least 65 percent of the materials processed are solid waste*. For each qualified solid waste disposal process, if the annual percentage of solid waste used in that process for each year that the issue is outstanding equals at least 65 percent of the materials used in that process, then all of the costs of the property used for such process are treated as allocable to a qualified solid waste disposal process. The percentage of solid waste used in such process for any year is the percentage, by weight or volume, of the total materials used in that process that constitute solid waste for that year.

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

Example 1. Nonqualified unused material—cloth. Company A takes wool and weaves it into cloth and then sells the cloth to a manufacturer to manufacture clothing. The cloth is material that has not been used previously as an agricultural, commercial, consumer, or industrial product or as a component of any such product. Accordingly, the cloth is not solid waste.

Example 2. Residual material from refining of crude Oil. Company B takes crude oil and refines it into various products, including finished motor gasoline, distillate fuel oil, and jet fuel. The balance of the crude oil remaining after this production process is in the form of a nonhazardous material which subsequently is used to make asphalt. This nonhazardous material constitutes less than 5 percent of the total crude oil that was introduced into the production process and it has a fair market value that is reasonably expected to be lower than that of any product produced in that oil refining process. The portion of the crude oil that remains after the refining process as the nonhazardous material is residual material within the meaning of paragraph (c)(1)(i)(B) of this section that qualifies as solid waste. The portion of the facility directly related to the production of asphalt from such residual material may be treated as a qualified solid waste disposal facility up to the point of the production of a first useful product (here asphalt) within the meaning of paragraph (e) of this section from the residual material.

Example 3. Residual material—waste coal. Company C mines coal. Less than 5 percent of ore mined is low quality byproduct of coal mining known as waste coal, which cannot be converted to energy under a normal energy-production process because the BTU content is too low. Waste coal has a lower fair market value than any product produced in the coal mining operation. Waste coal is solid waste because it is residual material within the meaning of paragraph (c)(1)(i)(B) of this section and Company C reasonably expects to introduce the waste coal into a solid waste disposal process. A facility that converts this waste coal into energy may be treated as a solid waste disposal facility.

Example 4. Virgin material—logs. Company D cuts down trees and sells the lumber to another company, which further processes the lumber into paper. In order to facilitate shipping, Company D cuts the trees into uniform logs. The trees are not solid waste because they are virgin materials within the meaning of paragraph (c)(2)(i) of this section. The division of such trees into uniform logs does not change the status of the trees as virgin material.

Example 5. Qualified solid waste disposal process—Landfill. Company E plans to construct a landfill. The landfill will not be subject to the final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on the date of enactment of the Tax Reform Act of 1986). Company E expects that the landfill will be filled entirely with material that will qualify as solid waste within the meaning of paragraph (c) of this section. Company E does not expect that a significant portion of the material placed in the landfill will be virgin materials or precious metals. Placing solid waste into a landfill is a qualified solid waste disposal process. The landfill is a qualified solid waste disposal facility.

Example 6. Qualified solid waste disposal process—Recycling Tires. Company F owns a facility that converts old, previously used tires into roadbed material. The used tires are used material within the meaning of paragraph (c)(1)(i)(A) of this section that qualifies as solid waste. Between the introduction of the old tires into the roadbed manufacturing process and the completion of the roadbed material, the facility does not create any interim useful products. The process for the manufacturing of the roadbed material from the old tires is a qualified solid waste disposal process as a recycling process and the facility that converts the tires into roadbed material is a qualified solid waste disposal facility. This conclusion would be the same if the recycling process took place at more than one plant.

Example 7. Nonqualified refurbishment. Company G purchases used cars and restores them. This restoration process includes disassembly, cleaning, and repairing of the cars. Parts that cannot be repaired are replaced. The restored cars contain at least 30 percent of the original pieces. While the cars are solid waste, the refurbishing process is not a qualified solid waste disposal process. Accordingly, Company G's facility is not a qualified solid waste disposal facility.

Example 8. Qualified solid waste disposal facility—first useful product rule—paper recycling. Company H employs an integrated process to re-pulp discarded magazines, clean the pulp, and produce retail paper towel products. Operational constraints on Company H's process do not allow for reasonable extraction, isolation, and sale of the cleaned paper pulp independently without degradation of the pulp. Company H further processes the paper pulp into large industrial-sized rolls of paper which are about 12 feet in diameter. At this point in the process, Company H could either sell such industrial-sized rolls of paper to another company for further processing to produce retail paper products or it could produce those retail products itself. In general, paper pulp is a useful product that is bought and sold on the market as a material for input into manufacturing or production processes. The discarded magazines are solid waste because they are used material within the meaning of paragraph (c)(1)(i)(A) of this section. Company H's facility is engaged in a recycling process within the meaning of paragraph (d)(3) of this section to the extent that it repulps and cleans the discarded magazines generally and further to the extent that it produces industrial-sized rolls of paper under the particular circumstances here. Specifically, taking into account the operational constraints on Company H's facility that limit its ability reasonably to extract, isolate, and sell the paper pulp independently, the first useful products within the meaning of paragraph (e) of this section from Company H's recycling process are the industrial-sized rolls of paper. The portion of Company H's facility that produces industrial-sized rolls of paper is a qualified solid waste disposal facility, and the portion of Company H's facility that further processes the industrial-sized rolls of paper into retail paper towels is not a qualified solid waste facility. Further, if the operational characteristics of Company H's facility allowed for reasonable extraction, isolation, and sale of the paper pulp independently, the first useful product would be the paper pulp and the portion of Company H's facility that cleans and re-pulps the magazines before processing in the paper machine to produce industrial-sized rolls of paper would be a qualified solid waste disposal facility.

Example 9. First useful product rule—energy conversion process. Company I receives solid waste from a municipal garbage collector. Company I burns that solid waste in an incinerator to remove exhaust gas and to produce heat. Company I further processes the heat in a heat exchanger to produce steam. Company I further processes the steam to generate electricity. The first useful product in this process is the useful energy in the form of steam. The facilities used to burn the solid waste and then capture the steam as useful energy are qualified solid waste disposal facilities because they process solid waste in an energy conversion process. The generating facilities used for further processing of the steam to create electricity do not engage in the energy conversion process and are not qualified solid waste disposal facilities.

Example 10. Preliminary function. Company J owns a paper mill. At the mill, logs from nearby timber operations are processed through a machine that removes bark. The stripped logs are used to manufacture paper. The stripped bark represents less than 5 percent of the logs processed into paper and has a lower fair market value than any product produced from the paper mill. The stripped bark falls onto a conveyor belt that transports the bark to a storage bin that is used to store the bark briefly until Company J feeds the bark into a boiler. The conveyor belt and storage bin are used only for these purposes. The boiler is used only to create steam by burning the bark, and the steam is used to generate electricity. The stripped bark is solid waste because it is residual material within the meaning of paragraph (c)(1)(i)(B) of this section and because Company J expects to introduce the bark into a conversion process within a reasonable period of time. The creation of steam from the stripped bark is an energy conversion process that starts with the incineration of the stripped bark. The energy conversion process is a qualified solid waste disposal process. The conveyor belt performs a collection activity that is preliminary and that is directly related to the solid waste disposal function. The storage bin performs a storage function that is preliminary and that is directly related to the solid waste disposal function. Thus, the conveyor belt and storage bin are solid waste disposal facilities. The bark removal process is not a preliminary function because it is not directly related to the energy conversion process and it does not become so related merely because it results in material that is solid waste.

Example 11. Mixed-input facility. Company K owns an incinerator financed by an issue and uses the incinerator exclusively to burn coal and solid material to create steam that is used to generate electricity. Each year while the issue is outstanding, 40 percent by volume and 45 percent by weight of the solid material that Company K processes in the conversion process is coal. The remainder of the solid material is either used material or residual material within the meaning of paragraph (c)(1)(i) of this section. Sixty percent of the costs of the property used to perform the energy conversion process are allocable to a solid waste disposal function.

Example 12. Mixed-function facility. Company L owns and operates a facility financed by an issue and uses the facility exclusively to sort damaged bottles from undamaged bottles that may be re-used. The damaged bottles are directly introduced into a process that melts them for use in the fabrication of an end product. The damaged bottles are solid waste within the meaning of paragraph (b)(1) of this section, and the melting process is a qualified solid waste disposal process as a recycling process within the meaning of paragraph (c)(3) of this section. Refilling the bottles is not a qualified solid waste disposal process. Each year while the issue is outstanding, more than 50 percent, by weight or volume, of all of the bottles that pass out of the sorting process are damaged bottles that are processed in a recycling process. The sorting facility performs a preliminary function, but it also performs another function. The costs of the sorting facility allocable to the preliminary function are determined using any reasonable method, based on all the facts and circumstances.

(i) *Effective Dates*—(1) *In general*. This section applies to bonds to which section 142 applies that are sold on or after the date that is 60 days after publication of final regulations in the **Federal Register**.

(2) *Elective retroactive application*. Issuers may apply this section to bonds sold before the date that is 60 days after publication of final regulations in the **Federal Register**.

PART 17—TEMPORARY INCOME TAX REGULATIONS UNDER 26 U.S.C. 103C

Par. 4. The authority citation for part 17 continues to read in part as follows:

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

Par. 5. Section 17.1 is removed.

§17.1 [Removed].

Linda M. Kroening,
(Acting) Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 15, 2009, 8:45 a.m., and published in the issue of the Federal Register for September 16, 2009, 74 F.R. 47500)

IRS and the George Washington University Law School to Sponsor Institute on International Tax Issues

Announcement 2009–77

The Internal Revenue Service announces the Twenty-Second Annual Institute on Current Issues in International Taxation, jointly sponsored by the Internal Revenue Service and The George Washington University Law School, to be held on December 10 and 11, 2009, at the J.W. Marriott Hotel in Washington, DC. Registration is currently underway for the Institute, which is intended for international tax professionals.

The program will present a unique opportunity for top IRS and Treasury officials and tax experts, foreign government tax authorities, and leading private sector specialists, to address breaking issues and present key perspectives on new developments.

The first day will also feature sessions on:

- Competent Authority
- Permanent Establishment: When You See It, When You Don't
- Current Topics in Repatriation Planning
- Losses in a Down Economy: International Issues and Planning Responses
- Emerging Issues in Cross-Border Workouts
- Offshore Tax Compliance in Today's Economy

The second day will focus on:

- Ethical Issues in International Tax Practice
- Outbound Update
- Inbound Update
- Key Tax Issues in Contract Manufacturing Business Models

On the first day, Douglas H. Shulman, Commissioner of the Internal Revenue Service, will deliver the luncheon address. On the second day, Michael F. Mundaca, Acting Assistant Treasury Secretary for Tax Policy of the Treasury, will deliver the luncheon address. The second day will also include an "Ask the IRS" panel featuring senior officials from the Service.

Those interested in attending or obtaining more information should contact The George Washington University Law School, at *http://www.law.gwu.edu/ciit/*.

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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[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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Key to Abbreviations:

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

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