Internal Revenue
bulletin

Bulletin No. 2009-49
December 7, 2009

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2009–38, page 736.

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

T.D. 9470, page 738.

Final regulations under section 6039 of the Code require corporations to file an information return with the IRS and furnish a written statement to each employee regarding: (i) the corporation's transfer of stock pursuant to the employee's exercise of an incentive stock option described in section 422(b); and (ii) transfers of stock by the employee where the stock was acquired pursuant to the exercise of an option described in section 423(c). The time and manner for filing a return and furnishing statements to employees, as well as the information to be contained in the return and furnished to employees, are addressed in these final regulations.

T.D. 9471, page 722.

Final regulations under section 423 of the Code provide the requirements that must be satisfied in order for a plan to meet the definition of an employee stock purchase plan. Section 423 also addresses the individual income tax treatment of stock acquired pursuant to an option granted under an employee stock purchase plan. The regulations update the existing regulations and provide additional guidance in certain areas.

REG–139255–08, page 747.

Proposed regulations under section 6050W of the Code relate to information reporting requirements, information reporting penalties, and backup withholding requirements for payment card and third party network transactions. A public hearing is scheduled for February 10, 2010.

Rev. Proc. 2009–52, page 744.

This procedure provides guidance to taxpayers on electing the 3, 4, or 5 year carryback of net operating losses or losses from operations under section 13 of the Worker, Homeownership, and Business Assistance Act of 2009.

EMPLOYEE PLANS

T.D. 9470, page 738.

Final regulations under section 6039 of the Code require corporations to file an information return with the IRS and furnish a written statement to each employee regarding: (i) the corporation's transfer of stock pursuant to the employee's exercise of an incentive stock option described in section 422(b); and (ii) transfers of stock by the employee where the stock was acquired pursuant to the exercise of an option described in section 423(c). The time and manner for filing a return and furnishing statements to employees, as well as the information to be contained in the return and furnished to employees, are addressed in these final regulations.

T.D. 9471, page 722.

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(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EXEMPT ORGANIZATIONS

Announcement 2009–86, page 759.
The IRS has revoked its determination that the Gehrig and Margaret White Charitable Foundation of Charlotte, NC; and the Downs Family Foundation of Detroit, MI, qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Code.

EMPLOYMENT TAX

Rev. Proc. 2009–53, page 746.
This procedure extends the sunset date of the Attributed Tip Income Program (ATIP) for two additional years until December 31, 2011. With the exception of this extension, requirements for ATIP as set forth in Rev. Proc. 2006–30, 2006–2 C.B. 110, remain unchanged. Rev. Proc. 2006–30 modified.

ADMINISTRATIVE

REG–139255–08, page 747.
Proposed regulations under section 6050W of the Code relate to information reporting requirements, information reporting penalties, and backup withholding requirements for payment card and third party network transactions. A public hearing is scheduled for February 10, 2010.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

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

The adjusted applicable federal long-term rate is set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 421.—General Rules

Final regulations clarify the requirements for establishing the date of grant for an option granted pursuant to an employee stock purchase plan under section 423. See T.D. 9471, page 722.

Section 422.—Incentive Stock Options

Final regulations clarify the shareholder approval requirements related to incentive stock options under section 422. See T.D. 9471, page 722.

Section 423.—Employee Stock Purchase Plans

Final regulations provide guidance to assist taxpayers in complying with the rules under section 423 regarding options granted under an employee stock purchase plan. See T.D. 9471, page 722.

26 CFR 1.423–2: Employee stock purchase plan defined.

T.D. 9471

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR part 1

Employee Stock Purchase Plans Under Internal Revenue Code Section 423

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains the final regulations relating to options granted under an employee stock purchase plan as defined in section 423 of the Internal Revenue Code (Code). These final regulations affect certain taxpayers who participate in the transfer of stock pursuant to the exercise of options granted under an employee stock purchase plan. These final regulations provide guidance to assist taxpayers in complying with section 423 in addition to clarifying certain rules regarding options granted under an employee stock purchase plan. This document also contains final regulations under sections 421, 422 and 424 of the Code.

DATES: *Effective Date:* These regulations are effective on November 17, 2009.

Applicability Date: These regulations apply as of January 1, 2010.

FOR FURTHER INFORMATION CONTACT: Thomas Scholz or Ilya Enkishev at (202) 622–6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final amendments to the Income Tax Regulations (26 CFR part 1) under sections 421, 422, 423 and 424 of the Code.

Section 423 was added to the Code by section 221(a) of the Revenue Act of 1964, Public Law 88–272 (78 Stat. 63 (1964)). Changes to the applicable law concerning section 423 were made by sections 1402(b)(1)(C) and 1402(b)(2) of the Tax Reform Act of 1976, Public Law 94–455 (90 Stat. 1731 and 1732–1733 (1976)); section 1001(b)(5) of the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 1011 (1984)); section 1114 of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2451 (1986)); and sections 11801(c)(9)(D)(i), (ii) and 11801(c)(9)(E) of the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508 (104 Stat. 1388–525 (1990)).

Regulations under section 423 were published in the **Federal Register** on June 23, 1966 (T.D. 6887, 1966–2 C.B. 129). These regulations were amended on September 27, 1979 (T.D. 7645, 1979–2 C.B. 198), October 31, 1980 (T.D. 7728, 1980–2 C.B. 236), and December 1, 1988 (T.D. 8235, 1989–1 C.B. 117). In Notice 2004–55, 2004–2 C.B. 319 (August 23, 2004)) (see §601.601(d)(2)(ii)(*b*)), the IRS and the Treasury Department requested comments concerning whether the existing regulations under section 423 should be amended, and if so, what issues should be addressed.

On July 29, 2008, the Treasury Department published a notice of proposed rulemaking (REG–106251–08, 2008–39 I.R.B. 774) in the **Federal Register** (73 FR 43875) under section 423. A public hearing on the proposed regulations was held on January 15, 2009. Written and electronic comments responding to the notice of proposed rulemaking were received. After consideration of these comments, the Treasury Department adopts the proposed regulations as final regulations, with the modifications set forth in this Treasury decision. The significant revisions are discussed in this preamble.

In general, the income tax treatment of the grant of an option to purchase stock in connection with the performance of services and of the transfer of stock pursuant

to the exercise of the option is determined under section 83 and the regulations thereunder. However, section 421 provides special rules for determining the income tax treatment of the transfer of shares of stock pursuant to the exercise of an option if the requirements of sections 422(a) or 423(a), as applicable, are met. Section 422 applies to incentive stock options and section 423 applies to options granted under an employee stock purchase plan (collectively, statutory options).

Under section 421, if a share of stock is transferred to an individual pursuant to the exercise of a statutory option, there is no income at the time of exercise of the option with respect to the transfer and no deduction under section 162 is allowed to the employer corporation with respect to the transfer.

Section 423(a) provides that section 421 applies to the transfer of stock to an individual pursuant to the exercise of an option granted under an employee stock purchase plan if: (i) no disposition of the stock is made within two years from the date of grant of the option or within one year from the date of transfer of the share, and (ii) at all times during the period beginning on the date of grant and ending on the day three months before the exercise of the option, the individual is an employee of either the corporation granting the option or a parent or subsidiary of such corporation, or a corporation (or a parent or subsidiary of such corporation) issuing or assuming a stock option in a transaction to which section 424(a) applies. Section 423(b) sets forth several requirements that must be met for a plan to qualify as an employee stock purchase plan. Section 423(c) provides a special rule that is applicable where the option exercise price is between 85 and 100 percent of the fair market value of the stock at the time the option was granted.

Explanation of Provisions

These final regulations provide a comprehensive set of rules governing stock options issued under an employee stock purchase plan and incorporate substantially all of the rules contained in the existing regulations under section 423. These final regulations are comprised of two sections: Section 1.423–1, applicability of section 421(a); and §1.423–2, employee stock purchase plan defined. The modifications to the proposed regulations that are included in these final regulations reflect consideration of the comments submitted by taxpayers.

1. General requirements

The proposed regulations provide that an employee stock purchase plan must meet the requirements of paragraphs (i) through (ix) of §1.423–2(a)(2) to qualify as an employee stock purchase plan under section 423(b). The proposed regulations also provide that the requirements of paragraphs (iii) through (ix) of §1.423–2(a)(2) may be satisfied by the terms of the plan or an offering made under the plan. The final regulations adopt these requirements of the proposed regulations, although the numerical designation of the requirements is modified. To emphasize that the requirements of paragraphs (iii) through (ix) of §1.423–2(a)(2) of the proposed regulations may be satisfied by the terms of the plan or an offering made under the plan, these final regulations separately list these requirements in §1.423–2(a)(3).

Commenters requested clarification of whether options with terms that are inconsistent with the terms of the plan will be eligible for the special tax treatment of section 421. As provided in §1.423–2(a)(3) of the proposed regulations, §1.423–2(a)(4) of these final regulations provides that, if the terms of an option are inconsistent with the terms of the employee stock purchase plan or an offering under the plan, then the option will not be treated as granted under an employee stock purchase plan. However, an option may still qualify for the special tax treatment of section 421, even if the terms of the plan are inconsistent with any of the requirements in §1.423–2(a)(3) of these final regulations, if the option is granted under an offering with terms that comply with the requirements of §1.423–2(a)(3). *Example 2* of §1.423–2(e)(6) of these final regulations illustrates this principle.

2. Offerings under an employee stock purchase plan

These final regulations provide further guidance for employee stock purchase plans under which more than one offering is made. As set forth in §1.423–2(a)(1) of these final regulations, one or more offerings may be made under a plan and the offerings may be consecutive or overlapping. Further, pursuant to section 423(b) and its flush language, the terms of each offering need not be identical. Although the terms of each offering need not be identical, the terms of the plan and each offering together must satisfy the requirements of §1.423–2(a)(2) and (3) of these final regulations. For example, if overlapping offerings are made under an employee stock purchase plan, then each offering may contain different terms, provided that the terms of each offering (together with the plan) satisfy the requirements of §1.423–2(a)(3) of these final regulations. Furthermore, when a parent corporation adopts an employee stock purchase plan, it may establish separate offerings with different terms under the plan and designate which subsidiary corporations of the parent corporation may participate in a particular offering, provided that the terms of each offering (together with the plan) satisfy the requirements of §1.423–2(a)(3). The terms "parent corporation" and "subsidiary corporation" are defined in §1.424–1(f) of the regulations.

a. Employees covered by the plan

Paragraphs (i) through (iv) of §1.423–2(e)(1) of the proposed regulations and these final regulations set forth the categories of employees that may be excluded from coverage under an employee stock purchase plan or an offering under the plan. The proposed regulations provide that the exclusions for various categories of employees must be applied in an identical manner to all employees of every corporation whose employees are granted options under the plan. Commenters noted that the requirement of identical exclusions for all offerings under a plan constrains the ability to make future and overlapping offerings that are more (or less) inclusive than prior offerings under the plan. Commenters suggested that the final regulations should permit multiple offerings under a plan with different exclusions applicable to the one or more corporations whose employees participate in the particular offering under the plan.

These final regulations generally adopt the approach suggested by the com-

menters. Pursuant to these final regulations, whether the terms of a plan and offering satisfy the requirements of §1.423–2(e) is made on an offering-by-offering basis. The terms of each offering under a plan may be different, provided the plan and offering together satisfy the requirements of §1.423–2(a)(2) and (3) of these final regulations. With respect to satisfying the requirements of §1.423–2(e), the terms of each offering may provide different exclusions of employees, as permitted and within the limitations described in §1.423–2(e)(1), (2) and (3) of these final regulations. The exclusions established with respect to a particular offering must be applied in an identical manner to all employees of every corporation whose employees are granted options under that particular offering. *Examples 7* and *8* of §1.423–2(e)(6) of these final regulations illustrate these principles.

Some commenters suggested that the final regulations permit employers to exclude from plan participation employees who are nonresident aliens and who receive no earned income that constitutes income from sources within the United States. Other commenters suggested that the final regulations permit employers to exclude from plan participation employees under a specified age. The IRS and the Treasury Department are aware of the complexities often associated with participation in an employee stock purchase plan by nonresident aliens and employees under a specified age, such as the age of majority. However, section 423 does not provide exclusions for nonresident aliens or employees under a specified age. Accordingly, the IRS and the Treasury Department are constrained by statutory authority from providing a general exclusion from plan participation for employees who are nonresident aliens or employees under a specified age.

One commenter suggested that the final regulations provide additional flexibility by permitting employers to exclude from plan participation highly compensated employees (HCEs) (within the meaning of section 414(q)) on any basis. Section 1.423–2(e)(2)(ii) of the proposed regulations provides that the terms of an employee stock purchase plan may exclude HCEs: (a) with compensation above a certain level, or (b) who are officers or subject to the disclosure requirements of section 16(a) of the Securities Exchange Act of 1934, provided the exclusion is applied in an identical manner to all HCEs of every corporation whose employees are granted options under the plan. These final regulations do not adopt the suggestion that HCEs may be excluded from participation in an employee stock purchase plan on any basis. Instead, these final regulations offer some additional flexibility by providing that, with respect to the exclusion of HCEs, the terms of each offering made under a plan need not be identical with respect to the HCEs, provided the HCEs are excluded as permitted and within the limitations described in §1.423–2(e)(2)(ii) of these final regulations.

b. Equal rights and privileges

Commenters further suggested that the final regulations provide flexibility by permitting employers to make multiple offerings with different rights and privileges applicable to the participants of each offering under a plan. These final regulations generally adopt the approach suggested by the commenters. Pursuant to these final regulations, the determination of whether the terms of an offering satisfy the requirements of §1.423–2(f) is made on an offering-by-offering basis. The terms of each offering under a plan may be different, provided the plan and offering together satisfy the requirements of §1.423–2(a)(2) and (3) of these final regulations. However, the rights and privileges established with respect to a particular offering must be applied in an identical manner to all employees of every corporation whose employees are granted options under that particular offering. *Examples 4* and *5* of §1.423–2(f)(7) of these final regulations illustrate these principles.

3. Maximum number of shares that may be purchased by an employee

Commenters asked whether the designation of a maximum number of shares that may be purchased by an employee during the offering is necessary in order for the first day of the offering period to be the date of grant. Consistent with the proposed regulations, §1.423–2(h)(3) of these final regulations provides that the date of grant will be the first day of an offering period if the terms of an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each employee during the offering. Similarly, the date of grant will be the first day of an offering if the terms of the plan or offering require the application of a formula to establish, on the first day of the offering, the maximum number of shares that may be purchased by each employee during the offering.

However, §1.423–2(h)(3) of these final regulations does not require that an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each employee during the offering or incorporate a formula to establish a maximum number of shares that may be purchased by each employee during the offering. If the maximum number of shares that can be purchased under an option is not fixed or determinable until the date the option is exercised, then the date of exercise will be the date of grant of the option. As discussed in the preamble to the proposed regulations, the $25,000 limit under section 423(b)(8) and the limit on the aggregate number of shares that may be issued under an employee stock purchase plan are not sufficient to establish the maximum number of shares that can be purchased by an employee under an option so that the date of grant will be the first day of the offering. *Examples 1, 2, 3* and *4* in §1.423–2(h)(4) of these final regulations illustrate these principles.

Commenters also asked whether any particular number of shares is necessary to satisfy the requirement to designate a maximum number of shares that may be purchased during the offering in order for the first day of the offering period to be the date of grant. No particular number of shares is necessary to satisfy this requirement and establish the first day of the offering period as the date of grant for the option. These final regulations adopt §1.423–2(h)(3) of the proposed regulations to provide that the designation of any maximum number of shares is sufficient to establish the first day of the offering period as the date of grant for the option.

4. Annual $25,000 limitation

Section 423(b)(8) provides that an employee stock purchase plan must, by its terms, provide that no employee may be

permitted to accrue the right to purchase stock under all the employee stock purchase plans of his or her employer corporation and its related corporations at a rate which exceeds $25,000 in fair market value of the stock (determined on the date of grant) for each calendar year in which an option granted to the employee is outstanding. Section 423(b)(8)(A) provides that the right to purchase stock under an option accrues when the option first becomes exercisable.

In drafting the proposed regulations, the Treasury Department and the IRS were aware that taxpayers were interpreting the $25,000 limitation inconsistently. Certain taxpayers interpreted section 423(b)(8) to mean that the limit increases by $25,000 for each calendar year during which the option is outstanding and exercisable; other taxpayers interpreted the sections to mean that such limit increases for each calendar year during which the option is simply outstanding. Consistent with comments received by the Treasury Department and the IRS in response to Notice 2004–55, 2004–2 C.B. 319 (August 23, 2004)), (see §601.601(d)(2)(ii)(*b*)), the proposed regulations adopted an approach that was generally consistent with the $100,000 limitation for incentive stock options and interpreted section 423(b)(8) to mean that the limit increases by $25,000 for each calendar year during which the option is outstanding and exercisable.

In response to the proposed regulations, several commenters suggested that the Treasury Department and the IRS reconsider the calculation of the $25,000 limitation in section 423(b)(8). Commenters suggested that the regulations adopt an approach that permits an option to accrue at a rate of $25,000 for each calendar year that the option is simply outstanding. Specifically, even though section 423(b)(8)(A) provides that the right to purchase stock actually accrues when the option first becomes exercisable during a calendar year, the first sentence of section 423(b)(8) provides that the limit on accruals is $25,000 "for each year in which such option is outstanding." Upon further consideration and in response to the foregoing comments, these final regulations modify §1.423–2(i) of the proposed regulations to provide that the limit increases by $25,000 for each calendar year that an option is outstanding. *Example 5* in §1.423–2(i)(5) of these final regulations has been modified to illustrate this principle.

5. Stockholder approval requirements

To qualify as an employee stock purchase plan, section 423(b)(2) requires that the plan be approved by the stockholders of the granting corporation within 12 months before or after the date the plan is adopted. These final regulations clarify that new stockholder approval is required if there is a change in the shares with respect to which options are issued or a change in the granting corporation. In particular, these final regulations clarify that the stockholders of a subsidiary corporation include the parent corporation and any other stockholders of the subsidiary. Accordingly, these final regulations adopt *Example 1(iii)* in §1.423–2(c)(5) and *Example 1(iii)* in §1.422–2(b)(6) of the proposed regulations.

One commenter to the proposed regulations suggested that a conforming change be made to *Example 9(iii)* in §1.424–1(a)(10) which addresses the substitution of options in the context of an acquisition. *Example 9(iii)* in §1.424–1(a)(10), as previously set forth in the regulations, requires the stockholders of an acquiring company to approve an amendment of the option plan of an acquired corporate subsidiary to issue parent stock instead of subsidiary stock. The commenter proposed that the example be amended to require the acquiring company (instead of its stockholders) to approve the amendment of the option plan to issue parent stock instead of subsidiary stock. This amendment is consistent with *Example 1(iii)* in §1.423–2(c)(5) and *Example 1(iii)* in §1.422–2(b)(6) of these final regulations. Accordingly, *Example 9(iii)* in §1.424–1(a)(10) of these final regulations has been modified to reflect the adoption of the commenter's suggestion.

Effective/Applicability Date

These regulations apply as of January 1, 2010, and will apply to any statutory option granted on or after that date. Taxpayers may rely on these final regulations for the treatment of any statutory option granted prior to January 1, 2010.

Special Analyses

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

Drafting Information

The principal authors of these regulations are Thomas Scholz and Ilya Enkishev, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.421–1, paragraphs (c)(1) and (j)(1) are revised to read as follows:

§1.421–1 Meaning and use of certain terms.

* * * * *

(c) *Time and date of granting option.* (1) For purposes of this section and §§1.421–2 through 1.424–1, the language "the date of the granting of the option" and "the time such option is granted," and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer

of stock for sale to an individual under the terms and conditions of a statutory option. Except as set forth in §1.423–2(h)(2), a corporate action constituting an offer of stock for sale is not considered complete until the date on which the maximum number of shares that can be purchased under the option and the minimum option price are fixed or determinable.

* * * * *

(j) *Effective/applicability date*—(1) *In general*. Except for paragraph (c)(1) of this section, the regulations under this section are effective on August 3, 2004. Paragraph (c)(1) of this section is effective on November 17, 2009. Paragraph (c)(1) of this section applies to statutory options granted on or after January 1, 2010.

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Par. 3. Section 1.422–2, paragraph (b)(6), *Example 1* (iii) is revised to read as follows:

§1.422–2 Incentive stock options defined.

* * * * *

(b) * * *

(6) * * *

Example 1. * * *

(iii) Assume the same facts as in paragraph (i) of this *Example 1*, except that the plan was adopted on January 1, 2010. Assume further that the plan was approved by the stockholders of S (in this case, P) on March 1, 2010. On January 1, 2012, S changes the plan to provide that incentive stock options for P stock will be granted to S employees under the plan. Because there is a change in the stock available for grant under the plan, the change is considered the adoption of a new plan that must be approved by the stockholder of S (in this case, P) within 12 months before or after January 1, 2012.

* * * * *

Par. 4. Section 1.422–5, paragraph (f)(1) is revised to read as follows:

§1.422–5 Permissible provisions.

* * * * *

(f) *Effective/applicability date*—(1) *In general*. Except for §1.422–2(b)(6) *Example 1* (iii), the regulations under this section are effective on August 3, 2004. Section 1.422–2(b)(6) *Example 1* (iii) is effective on November 17, 2009. Section 1.422–2(b)(6) *Example 1* (iii) applies to statutory options granted on or after January 1, 2010.

* * * * *

Par. 5. Section 1.423–1 is revised to read as follows:

§1.423–1 Applicability of section 421(a).

(a) *General rule*. Subject to the provisions of section 423(c) and §1.423–2(k), the special rules of income tax treatment provided in section 421(a) apply with respect to the transfer of a share of stock to an individual pursuant to the individual's exercise of an option granted under an employee stock purchase plan, as defined in §1.423–2, if the following conditions are satisfied—

(1) The individual makes no disposition of such share before the later of the expiration of the two-year period from the date of the grant of the option pursuant to which such share was transferred or the expiration of the one-year period from the date of transfer of such share to the individual; and

(2) At all times during the period beginning on the date of the grant of the option and ending on the day three months before the date of exercise, the individual was an employee of the corporation granting the option, a related corporation, or a corporation (or a related corporation) substituting or assuming the stock option in a transaction to which section 424(a) applies.

(b) *Cross-references*. For rules relating to the requisite employment relationship, see §1.421–1(h). For rules relating to the effect of a disqualifying disposition, see section 421(b) and §1.421–2(b). For the definition of the term "disposition," see section 424(c) and §1.424–1(c). For the definition of the term "related corporation," see §1.421–1(i).

(c) *Effective/applicability date*. The regulations under this section are effective on November 17, 2009. The regulations under this section apply to options granted under an employee stock purchase plan on or after January 1, 2010.

Par. 6. Section 1.423–2 is revised to read as follows:

§1.423–2 Employee stock purchase plan defined.

(a) *In general*—(1) The term "employee stock purchase plan" means a plan that meets the requirements of paragraphs (a)(2) and (a)(3) of this section. If the terms of the plan do not satisfy the requirements of paragraph (a)(3) of this section, then such requirements may be satisfied by the terms of an offering made under the plan. However, where the requirements of paragraph (a)(3) of this section are satisfied by the terms of an offering, such requirements will be treated as satisfied only with respect to options exercised under that offering. One or more offerings may be made under an employee stock purchase plan. Offerings may be consecutive or overlapping, and the terms of each offering need not be identical provided the terms of the plan and the offering together satisfy the requirements of paragraphs (a)(2) and (a)(3) of this section. The plan and the terms of an offering must be in writing or electronic form, provided that such writing or electronic form is adequate to establish the terms of the plan or offering, as applicable.

(2) To satisfy the requirements of this paragraph (a)(2) and §1.423–1, the plan must meet both of the following requirements—

(i) The plan must provide that options can be granted only to employees of the employer corporation or of a related corporation (as defined in paragraph (i) of §1.421–1) to purchase stock in any such corporation (see paragraph (b) of this section); and

(ii) The plan must be approved by the stockholders of the granting corporation within 12 months before or after the date the plan is adopted (see paragraph (c) of this section).

(3) To satisfy the requirements of this paragraph (a)(3) and §1.423–1, the terms of the plan or offering must meet all of the following requirements—

(i) An employee cannot be granted an option if, immediately after the option is granted, the employee owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of a related corporation (see paragraph (d) of this section);

(ii) Options must be granted to all employees of any corporation whose employees are granted any options by reason of their employment by the corporation (see paragraph (e) of this section);

(iii) All employees granted options must have the same rights and privileges (see paragraph (f) of this section);

(iv) The option price cannot be less than the lesser of—

(A) An amount equal to 85 percent of the fair market value of the stock at the time the option is granted, or

(B) An amount not less than 85 percent of the fair market value of the stock at the time the option is exercised (see paragraph (g) of this section).

(v) Options cannot be exercised after the expiration of—

(A) Five years from the date the option is granted if, under the terms of such plan, the option price cannot be less than 85 percent of the fair market value of the stock at the time the option is exercised, or

(B) Twenty-seven months from the date the option is granted, if the option price is not determined in the manner described in paragraph (a)(3)(v)(A) of this section (see paragraph (h) of this section).

(vi) No employee may be granted an option that permits the employee's rights to purchase stock under all employee stock purchase plans of the employer corporation and its related corporations to accrue at a rate that exceeds $25,000 of fair market value of the stock (determined at the time the option is granted) for each calendar year in which the option is outstanding at any time (see paragraph (i) of this section); and

(vii) Options are not transferable by the optionee other than by will or the laws of descent and distribution, and are exercisable, during the lifetime of the optionee, only by the optionee (see paragraph (j) of this section).

(4) The determination of whether a particular option is an option granted under an employee stock purchase plan is made at the time the option is granted. If the terms of an option are inconsistent with the terms of the employee stock purchase plan or the offering under the plan pursuant to which the option is granted, the option will not be treated as granted under an employee stock purchase plan. If an option with terms that are inconsistent with the terms of the plan or an offering under the plan is granted to an employee who is entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under the offering that qualifies as an option granted under an employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421. However, if an option with terms that are inconsistent with the terms of the plan or an offering under the plan is granted to an individual who is not entitled to the grant of an option under the terms of the plan or offering, the option will not be treated as an option granted under an employee stock purchase plan but the grant of the option will not disqualify the options granted under the plan or offering. If, at the time of grant, an option qualifies as an option granted under an employee stock purchase plan, but after the time of grant one or more of the requirements of paragraph (a)(3) of this section is not satisfied with respect to the option, the option will not be treated as granted under an employee stock purchase plan but this failure to comply with the terms of the option will not disqualify the other options granted under the plan or offering.

(5) *Examples*. The following examples illustrate the principles of paragraph (a):

Example 1. Corporation A operates an employee stock purchase plan under which options for A stock are granted to employees of A. The terms of an offering provide that the option price will be 90 percent of the fair market value of A stock on the date of exercise. A grants an option under the offering to Employee Z, an employee of A. The terms of the option provide that the option price will be 85 percent of the fair market value of A stock on the date of exercise. Because the terms of Z's option are inconsistent with the terms of the offering, the option granted to Z will not be treated as an option granted under the employee stock purchase plan. Further, unless Z is granted an option under the offering that qualifies as an option granted under the employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section and none of the options granted under the offering will be eligible for the special tax treatment of section 421.

Example 2. Corporation B operates an employee stock purchase plan that provides that options for B stock may only be granted to employees of B. Under the terms of the plan, options may not be granted to consultants and other non-employees. B grants an option to Consultant Y, a consultant of B. Because Y is ineligible to receive an option under the plan because Y is not an employee, the grant of the option to Y is inconsistent with the terms of the plan and the option granted to Y will not be treated as an option granted under the employee stock purchase plan. However, the grant of the option to Y will not disqualify the options granted under the plan or any offering because Y was not entitled to the grant of an option under the plan.

Example 3. Corporation C operates an employee stock purchase plan under which options for C stock are granted to employees of C. C grants an option pursuant to an offering under the plan to Employee X, an employee of C who is a highly compensated employee. The terms of the employee stock purchase plan exclude highly compensated employees from participation in the plan. Because X is ineligible to receive an option under the plan by reason of X's exclusion from participation in the plan, the option granted to X will not be treated as an option granted under the employee stock purchase plan. However, the grant of the option to X will not disqualify the options granted under the plan or offering because X was not entitled to the grant of an option under the plan.

Example 4. Corporation D operates an employee stock purchase plan under which options for D stock are granted to employees of D. D grants an option pursuant to an offering under the plan to Employee W, an employee of D. The terms of the option provide that the option price will be 90 percent of the fair market value of D stock on the date of exercise. On the date of exercise, W pays only 85 percent of the fair market value of D stock. Because the terms of W's option are not satisfied, the option granted to W will not be treated as an option granted under the employee stock purchase plan. However, the failure to comply with the terms of the option granted to W will not disqualify the options granted under the plan or offering.

(b) *Options restricted to employees*. An employee stock purchase plan must provide that options can be granted only to employees of the employer corporation (or employees of its related corporations) to purchase stock in the employer corporation (or one of its related corporations). If such a provision is not included in the terms of the plan, the plan will not be an employee stock purchase plan and options granted under the plan will not qualify for the special tax treatment of section 421. For rules relating to the employment requirement, see §1.421–1(h).

(c) *Stockholder approval*—(1) An employee stock purchase plan must be approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted. The approval of the stockholders must comply with all applicable provisions of the corporate charter and bylaws and of applicable State law prescribing the method and degree of stockholder approval required for the issuance of corporate stock or options. If the applicable State law does not prescribe a method and degree of stockholder approval, then an employee stock purchase plan must be approved—

(i) By a majority of the votes cast at a duly held stockholder's meeting at which a quorum representing a majority of all outstanding voting stock is, either in person or by proxy, present and voting on the plan; or

(ii) By a method and in a degree that would be treated as adequate under applicable State law in the case of an action requiring stockholder approval (such as, an

action on which stockholders would be entitled to vote if the action were taken at a duly held stockholders' meeting).

(2) For purposes of the stockholder approval required by this paragraph (c), ordinarily, a plan is adopted when it is approved by the granting corporation's board of directors, and the date of the board's action is the reference point for determining whether stockholder approval occurs within the applicable 24-month period. However, if the board's action is subject to a condition (such as stockholder approval) or the happening of a particular event, the plan is adopted on the date the condition is met or the event occurs, unless the board's resolution fixes the date of adoption as the date of the board's action.

(3) An employee stock purchase plan, as adopted and approved, must designate the maximum aggregate number of shares that may be issued under the plan, and the corporations or class of corporations whose employees may be offered options under the plan. A plan that merely provides that the number of shares that may be issued under the plan may not exceed a stated percentage of the shares outstanding at the time of each offering or grant under the plan does not satisfy the requirements of this paragraph (c)(3). However, the maximum aggregate number of shares that may be issued under the plan may be stated in terms of a percentage of the authorized, issued, or outstanding shares on the date of the adoption of the plan. The plan may specify that the maximum aggregate number of shares available for grants under the plan may increase annually by a specified percentage of the authorized, issued, or outstanding shares on the date of the adoption of the plan. A plan that provides that the maximum aggregate number of shares that may be issued as options under the plan may change based on any other specific circumstances satisfies the requirements of this paragraph only if the stockholders approve an immediately determinable maximum number of shares that may be issued under the plan in any event. If there is more than one employee stock purchase plan under which options may be granted and stockholders of the granting corporation merely approve a maximum aggregate number of shares that are available for issuance under the plans, the stockholder approval requirements described in paragraph (c)(1) of this section are not satisfied. A separate maximum aggregate number of shares available for issuance pursuant to options must be specified and approved for each plan.

(4) Once an employee stock purchase plan is approved by the stockholders of the granting corporation, the plan need not be reapproved by the stockholders of the granting corporation unless the plan is amended or changed in a manner that is considered the adoption of a new plan, in which case the plan must be reapproved within the prescribed 24-month period. Any increase in the aggregate number of shares that may be issued under the plan (other than an increase merely reflecting a change in the number of outstanding shares, such as a stock dividend or stock split) will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. Similarly, a change in the designation of corporations whose employees may be offered options under the plan will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period unless the plan provides that designations of participating corporations may be made from time to time from among a group consisting of the granting corporation and its related corporations. The group from among which such changes and designations are permitted without additional stockholder approval may include corporations having become parents or subsidiaries of the granting corporation after the adoption and approval of the plan. In addition, a change in the granting corporation or the stock available for purchase under the plan will be considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. Any other changes in the terms of an employee stock purchase plan are not considered the adoption of a new plan and, thus, do not require stockholder approval.

(5) *Examples*. The following examples illustrate the principles of this paragraph (c):

Example 1. (i) Corporation E is a subsidiary of Corporation F, a publicly traded corporation. On January 1, 2010, E adopts an employee stock purchase plan under which options for E stock are granted to E employees.

(ii) To meet the requirements of paragraph (c)(1) of this section, the plan must be approved by the stockholders of E (in this case, F) within 12 months before or after January 1, 2010.

(iii) Assume the same facts as in paragraph (i) of this *Example 1*, except that the plan was approved by the stockholders of E (in this case, F) on March 1, 2010. On January 1, 2012, E changes the plan to provide that options for F stock will be granted to E employees under the plan. Because there is a change in the stock available for grant under the plan, under paragraph (c)(4) of this section, the change is considered the adoption of a new plan that must be approved by the stockholders of E (in this case, F) within 12 months before or after January 1, 2012.

Example 2. (i) Assume the same facts as in paragraph (i) of *Example 1*, except that on March 15, 2011, F completely disposes of its interest in E. Thereafter, E continues to grant options for E stock to E employees under the plan.

(ii) The new E options are granted under a plan that meets the stockholder approval requirements of paragraph (c)(1) of this section without regard to whether E seeks approval of the plan from the stockholders of E after F disposes of its interest in E.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*, except that under the plan as adopted on January 1, 2010, only options for F stock are granted to E employees. Assume further that, after F disposes of its interest in E, E changes the plan to provide for the grant of options for E stock to E employees. Because there is a change in the stock available for purchase or grant under the plan, under paragraph (c)(4) of this section, the stockholders of E must approve the plan within 12 months before or after the change to the plan to meet the stockholder approval requirements of paragraph (c) of this section.

Example 3. (i) Corporation G maintains an employee stock purchase plan providing options for G stock. Corporation H does not maintain an employee stock purchase plan. On May 15, 2010, G and H consolidate under State law to form one corporation. The new corporation is named Corporation H. The consolidation agreement describes the G plan, including the maximum aggregate number of shares available for issuance under the plan after the consolidation. Additionally, the consolidation agreement states that the plan will be continued by H after the consolidation. The consolidation agreement is approved by the stockholders of G and H on May 1, 2010. H assumes the plan formerly maintained by G and continues to grant options under the plan to all eligible employees, but the options are for H stock.

(ii) Because there is a change in the granting corporation (from G to H) and the stock available for purchase, under paragraph (c)(4) of this section, H is considered to have adopted a new plan. Because the plan is fully described in the consolidation agreement, including the maximum aggregate number of shares available for issuance under the plan, the approval of the consolidation agreement by the stockholders constitutes approval of the plan. Thus, the stockholder approval of the consolidation agreement satisfies the stockholder approval requirements of paragraph (c)(1) of this section, and the plan is considered to be adopted by H and approved by its stockholders on May 1, 2010.

Example 4. Corporation I adopts an employee stock purchase plan on November 1, 2010. On that date, there are two million shares of I stock outstanding. The plan provides that the maximum aggregate number of shares that may be issued under the plan

may not exceed 15 percent of the number of shares of I stock outstanding on November 1, 2010. Because the maximum aggregate number of shares that may be issued under the plan is designated in the plan, the requirements of paragraph (c)(3) of this section are met.

Example 5. (i) Corporation J adopts an employee stock purchase plan on March 15, 2010. The plan provides that the maximum aggregate number of shares of J stock available for issuance under the plan is 50,000, increased on each anniversary date of the adoption of the plan by 5 percent of the then outstanding shares. Because the maximum aggregate number of shares is not designated under the plan, the requirements of paragraph (c)(3) of this section are not met.

(ii) Assume the same facts as in paragraph (i) of this *Example 5*, except that the plan provides that the maximum aggregate number of shares available under the plan is the lesser of (a) 50,000 shares, increased each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares, or (b) 200,000 shares. Because the maximum aggregate number of shares that may be issued under the plan is designated as the lesser of two numbers, one of which provides an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event, the requirements of paragraph (c)(3) of this section are met.

(d) *Options granted to certain shareholders*—(1) An employee stock purchase plan or offering must, by its terms, provide that an employee cannot be granted an option if the employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or a related corporation. In determining whether the stock ownership of an employee equals or exceeds this 5 percent limit, the rules of section 424(d) (relating to attribution of stock ownership) shall apply, and stock that the employee may purchase under outstanding options (whether or not the options qualify for the special tax treatment afforded by section 421(a)) shall be treated as stock owned by the employee. An option is outstanding for purposes of this paragraph (d) although under its terms it may be exercised only in installments or after the expiration of a fixed period of time. If an option is granted to an employee whose stock ownership (as determined under this paragraph (d)) exceeds the limitation set forth in this paragraph (d), no portion of the option will be treated as having been granted under an employee stock purchase plan.

(2) The determination of the percentage of the total combined voting power or value of all classes of stock of the employer corporation (or a related corporation) that is owned by the employee is made by comparing the voting power or value of the shares owned (or treated as owned) by the employee to the aggregate voting power or value of all shares actually issued and outstanding immediately after the grant of the option to the employee. The aggregate voting power or value of all shares actually issued and outstanding immediately after the grant of the option does not include the voting power or value of treasury shares or shares authorized for issue under outstanding options held by the employee or any other person.

(3) *Examples*. The following examples illustrate the principles of this paragraph (d):

Example 1. Employee V, an employee of Corporation K, owns 6,000 shares of K common stock, the only class of K stock outstanding. K has 100,000 shares of its common stock outstanding. Because V owns 6 percent of the combined voting power or value of all classes of K stock, K cannot grant an option to V under K's employee stock purchase plan. If V's father and brother each owned 3,000 shares of K stock and V did not own any K stock, then the result would be the same because, under section 424(d), an individual is treated as owning stock held by the person's father and brother. Similarly, the result would be the same if, instead of actually owning 6,000 shares, V merely held an option on 6,000 shares of K stock, irrespective of whether the transfer of stock under the option could qualify for the special tax treatment of section 421, because this paragraph (d) provides that stock the employee may purchase under outstanding options is treated as stock owned by such employee.

Example 2. Assume the same facts as in *Example 1*, except that K is a 50 percent subsidiary corporation of Corporation L. Irrespective of whether V owns any L stock, V cannot receive an option from L under L's employee stock purchase plan because he owns 5 percent of the total combined voting power of all classes of stock of a subsidiary of L, in this example, K. An employee who owns (or is treated as owning) stock in excess of the limitation of this paragraph (d), in any corporation in a group of related corporations, consisting of a parent and its subsidiary corporations, cannot receive an option under an employee stock purchase plan from any corporation in the group.

Example 3. Employee U is an employee of Corporation M. M has only one class of stock, of which 100,000 shares are issued and outstanding. Assuming U does not own (and is not treated as owning) any stock in M or in any related corporation of M, M may grant an option to U under its employee stock purchase plan for 4,999 shares, because immediately after the grant of the option, U would not own 5 percent or more of the combined voting power or value of all classes of M stock actually issued and outstanding at such time. The 4,999 shares that U would be treated as owning under this paragraph (d) would not be added to the 100,000 shares actually issued and outstanding immediately after the grant for purposes of determining whether U's stock ownership exceeds the limitation of this paragraph (d).

Example 4. Assume the same facts as in *Example 3* but instead of an option for 4,999 shares, M grants U an option, purportedly under its employee stock purchase plan, for 5,000 shares. No portion of this option will be treated as granted under an employee stock purchase plan because U's stock ownership exceeds the limitation of this paragraph (d).

(e) *Employees covered by plan*—(1) Subject to the provisions of this paragraph (e) and the limitations of paragraphs (d), (f) and (i) of this section, an employee stock purchase plan or offering must, by its terms, provide that options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by that corporation, except that one or more of the following categories of employees may be excluded from the coverage of the plan or offering—

(i) Employees who have been employed less than two years;

(ii) Employees whose customary employment is 20 hours or less per week;

(iii) Employees whose customary employment is for not more than five months in any calendar year; and

(iv) Highly compensated employees (within the meaning of section 414(q)).

(2) A plan or offering does not fail to satisfy the coverage provision of paragraph (e)(1) of this section in the following circumstances—

(i) The plan or offering excludes employees who have completed a shorter period of service or whose customary employment is for fewer hours per week or fewer months in a calendar year than is specified in paragraphs (e)(1)(i), (ii) and (iii) of this section, provided the exclusion is applied in an identical manner to all employees of every corporation whose employees are granted options under the plan or offering.

(ii) The plan or offering excludes highly compensated employees (within the meaning of section 414(q)) with compensation above a certain level or who are officers or subject to the disclosure requirements of section 16(a) of the Securities Exchange Act of 1934, provided the exclusion is applied in an identical manner to all highly compensated employees of every corporation whose employees are granted options under the plan or offering.

(3) Notwithstanding paragraph (e)(1) of this section, employees who are citizens or residents of a foreign jurisdiction (without regard to whether they are also citizens of

the United States or resident aliens (within the meaning of section 7701(b)(1)(A))) may be excluded from the coverage of an employee stock purchase plan or offering under the following circumstances—

(i) The grant of an option under the plan or offering to a citizen or resident of the foreign jurisdiction is prohibited under the laws of such jurisdiction; or

(ii) Compliance with the laws of the foreign jurisdiction would cause the plan or offering to violate the requirements of section 423.

(4) No option granted under a plan or offering that excludes from participation any employees, other than those who may be excluded under this paragraph (e), and those barred from participation by reason of paragraphs (d), (f) and (i) of this section, can be regarded as having been granted under an employee stock purchase plan. If an option is not granted to any employee who is entitled to the grant of an option under the terms of the plan or offering, none of the options granted under such offering will be treated as having been granted under an employee stock purchase plan. However, a plan that, by its terms, permits all eligible employees to elect to participate in an offering will not violate the requirements of this paragraph solely because eligible employees who elect not to participate in the offering are not granted options pursuant to such offering.

(5) For purposes of this paragraph (e), the existence of the employment relationship between an individual and the corporation participating under the plan will be determined under §1.421–1(h).

(6) *Examples*. The following examples illustrate the principles of this paragraph (e):

Example 1. Corporation N has a stock purchase plan that meets all the requirements of paragraphs (a)(2) and (a)(3) of this section except that options are not required to be granted to employees whose weekly rate of pay is less than $1,000. As a matter of corporate practice, however, N grants options under its plan to all employees, irrespective of their weekly rate of pay. Even though N's plan is operated in compliance with the requirements of this paragraph (e), N's plan is not an employee stock purchase plan because the terms of the plan exclude a category of employees that is not permitted under this paragraph (e).

Example 2. Assume the same facts as in *Example 1*, except that the first offering under N's plan provides that options will be granted to all employees of N. The terms of the first offering will be treated as part of the terms of N's plan, but only for purposes of the first offering. Because the terms of the first offering satisfy the requirements of this paragraph (e), stock transferred pursuant to options exercised under the first offering will be treated as stock transferred pursuant to the exercise of options granted under an employee stock purchase plan for purposes of section 421.

Example 3. Corporation O has a stock purchase plan that excludes from participation all employees who have been employed less than one year. Assuming all other requirements of paragraphs (a)(2) and (a)(3) of this section are satisfied, O's plan qualifies as an employee stock purchase plan under section 423.

Example 4. Corporation P has a stock purchase plan that excludes from participation clerical employees who have been employed less than two years. However, non-clerical employees with less than two years of service are permitted to participate in the plan. P's plan is not an employee stock purchase plan because the exclusion of employees who have been employed less than two years applies only to certain employees of P and is not applied in an identical manner to all employees of P. If, instead, P's plan excludes from participation all employees (both clerical and non-clerical) who have been employed less than two years, then P's plan would qualify as an employee stock purchase plan under section 423 assuming all other requirements of paragraphs (a)(2) and (a)(3) of this section are satisfied.

Example 5. Corporation Q has a stock purchase plan that excludes from participation all officers who are highly compensated employees (within the meaning of section 414(q)). Assuming all other requirements of paragraphs (a)(2) and (a)(3) of this section are satisfied, Q's plan qualifies as an employee stock purchase plan under section 423.

Example 6. Corporation R maintains an employee stock purchase plan that excludes from participation all highly compensated employees (within the meaning of section 414(q)), except highly compensated employees who are officers of R. R's plan is not an employee stock purchase plan because the exclusion of all highly compensated employees except highly compensated employees who are officers of R is not a permissible exclusion under paragraph (e)(2)(ii) of this section.

Example 7. Corporation S is the parent corporation of Subsidiary YY and Subsidiary ZZ. S maintains an employee stock purchase plan with both YY and ZZ participating in the same offering under the plan. Under the terms of the offering under the plan, all employees of YY and ZZ are permitted to participate in the plan with the exception of ZZ's highly compensated employees with annual compensation greater than $300,000. None of the options granted under the offering will be considered granted under an employee stock purchase plan because the exclusion of highly compensated employees with annual compensation greater than $300,000 is not applied in an identical manner to all employees of YY and ZZ granted options in the same offering.

Example 8. Assume the same facts as in *Example 7*, except that Corporation S establishes separate offerings under the plan for YY and ZZ. Under the terms of the separate offering for YY, all employees of YY are permitted to participate in the plan. Under the terms of the separate offering established for ZZ, all employees of ZZ are permitted to participate in the plan with the exception of ZZ's highly compensated employees with annual compensation greater than $300,000. The options granted under the separate offering for YY will be considered granted under an employee stock purchase plan. Further, the options granted under the separate offering for ZZ will be considered granted under an employee stock purchase plan because the exclusion of highly compensated employees with annual compensation greater than $300,000 is applied in an identical manner to all employees of ZZ granted options in the same offering.

Example 9. The laws of Country A require that options granted to residents of Country A be transferable during the lifetime of the option recipient. Corporation T has a stock purchase plan that excludes residents of Country A from participation in the plan. Because compliance with the laws of Country A would cause options granted to residents of Country A to violate paragraph (j) of this section, T may exclude residents of Country A from participation in the plan. Assuming all other requirements of paragraph (a)(2) of this section are satisfied, T's plan qualifies as an employee stock purchase plan under section 423.

(f) *Equal rights and privileges*—(1) Except as otherwise provided in paragraphs (f)(2) through (f)(6) of this section, an employee stock purchase plan or offering must, by its terms, provide that all employees granted options under the plan or offering shall have the same rights and privileges. Thus, the provisions applying to one option under an offering (such as the provisions relating to the method of payment for the stock and the determination of the purchase price per share) must apply to all other options under the offering in the same manner. If all the options granted under a plan or offering do not, by their terms, give the respective optionees the same rights and privileges, none of the options will be treated as having been granted under an employee stock purchase plan for purposes of section 421.

(2) The requirements of this paragraph (f) do not prevent the maximum amount of stock that an employee may purchase from being determined on the basis of a uniform relationship to the total compensation, or the basic or regular rate of compensation, of all employees.

(3) A plan or offering will not fail to satisfy the requirements of this paragraph (f) because the plan or offering provides that no employee may purchase more than a maximum amount of stock fixed under the plan or offering.

(4) A plan or offering will not fail to satisfy the requirements of this paragraph (f) if, in order to comply with the laws of a foreign jurisdiction, the terms of an option granted under a plan or offering to cit-

izens or residents of such foreign jurisdiction (without regard to whether they are also citizens of the United States or resident aliens (within the meaning of section 7701(b)(1)(A))) are less favorable than the terms of options granted under the same plan or offering to employees resident in the United States.

(5)(i) Except as provided in this paragraph and paragraph (f)(5)(ii) of this section, a plan or offering permitting one or more employees to carry forward amounts that were withheld but not applied toward the purchase of stock under an earlier plan or offering and apply the amounts towards the purchase of additional stock under a subsequent plan or offering will be a violation of the equal rights and privileges under paragraph (f)(1) of this section. However, the carry forward of amounts withheld but not applied toward the purchase of stock under an earlier plan or offering will not violate the equal rights and privileges requirement of paragraph (f)(1) of this section, if all other employees participating in the current plan or offering are permitted to make direct payments toward the purchase of shares under a subsequent plan or offering in an amount equal to the excess of the greatest amount which any employee is allowed to carry forward from an earlier plan or offering over the amount, if any, the employee will carry forward from an earlier plan or offering.

(ii) A plan or offering will not fail to satisfy the requirements of this section merely because employees are permitted to carry forward amounts representing a fractional share, that were withheld but not applied toward the purchase of stock under an earlier plan or offering and apply the amounts toward the purchase of additional stock under a subsequent plan or offering.

(6) Paragraph (f) does not prohibit the delaying of the grant of an option to any employee who is barred from being granted an option solely by reason of the employee's failing to meet a minimum service requirement set forth in paragraph (e)(1) of this section until the employee meets such requirement.

(7) *Examples.* The following examples illustrate the principles of this paragraph (f):

Example 1. Corporation U has an employee stock purchase plan that provides that the maximum amount of stock that each employee may purchase under the offering is one share for each $100 of annual gross pay. The plan meets the requirements of this paragraph (f).

Example 2. Corporation V has an employee stock purchase plan that provides that the maximum amount of stock that each employee may purchase under the offering is one share for each $100 of annual gross pay up to and including $10,000, and two shares for each $100 of annual gross pay in excess of $10,000. The plan will not meet the requirements of this paragraph (f) because the amount of stock that may be purchased under the plan is not based on a uniform relationship to the total compensation of all employees.

Example 3. Corporation W has an employee stock purchase plan that provides that options to purchase stock in an amount equal to ten percent of an employee's annual salary at a price equal to 85 percent of the fair market value on the first day of the offering will be granted to all employees other than those who have been employed less than 18 months. In addition, the plan provides that employees who have not yet met the minimum service requirements on the first day of the offering will be granted similar options on the date the 18 month service requirement has been attained. The plan meets the requirements of this paragraph (f).

Example 4. Corporation X is the parent corporation of Subsidiary AA, Subsidiary BB and Subsidiary CC. X maintains an employee stock purchase plan with AA, BB and CC participating in the same offering under the plan. Under the terms of the offering under the plan, options to purchase stock at a price equal to 90 percent of the fair market value at the time the option is exercised will be granted to all employees. Certain employees of AA are residents of Country B. The laws of Country B provide that options granted to employees who are residents of Country B must have a purchase price not less than 95 percent of the fair market value at the time the option is exercised. The plan will not fail to satisfy the requirements of this paragraph (f) merely because the residents of Country B are granted options under the plan to purchase stock at a price equal to 95 percent of the fair market value at the time the option is exercised.

Example 5. Assume the same facts as in *Example 4*, except that Corporation X establishes two separate offerings under the plan: a separate offering for the employees of AA and a separate offering for the employees of BB and CC. Under the separate offering for the employees of BB and CC, options are granted to all employees with an exercise price equal to 90 percent of the fair market value at the time the option is exercised. Under the separate offering for the employees of AA, options are granted to all employees with an exercise price equal to 95 percent of the fair market value at the time the option is exercised. The plan does not violate the equal rights and privileges requirement of this paragraph (f) merely because the exercise price of options granted under one offering is less than the exercise price of options granted under a separate offering.

Example 6. Corporation Y maintains an employee stock purchase plan. Employee T is employed by Y. T is granted an option under the current offering to purchase a maximum of 100 shares of Y stock at an option price equal to 85 percent of the fair market value of the stock at exercise. The plan permits the carry forward of withheld but unused amounts from an earlier offering. Prior to the exercise date, $2000 of T's salary has been withheld and is available to be applied toward the purchase of Y stock. On the exercise date, the fair market value of Y stock is $20 per share. T is able to purchase 100 shares of Y stock at $17 per share for an aggregate purchase price of $1700. T can carry forward $300 to the subsequent offering. Each employee in the subsequent offering other than T will be permitted to make direct payments toward the purchase of shares under the subsequent offering in a maximum amount of $300 less any amount the employee has carried forward from an earlier offering. The plan does not violate the equal rights and privileges requirement of this paragraph (f).

(g) *Option price*—(1) An employee stock purchase plan or offering must, by its terms, provide that the option price will not be less than the lesser of—

(i) An amount equal to 85 percent of the fair market value of the stock at the time the option is granted, or

(ii) An amount that under the terms of the option may not be less than 85 percent of the fair market value of the stock at the time the option is exercised.

(2) For purposes of determining the option price, the fair market value of the stock may be determined in any reasonable manner, including the valuation methods permitted under §20.2031–2. However, the option price must meet the minimum pricing requirements of this paragraph (g). For general rules relating to the option price, see §1.421–1(e). For rules relating to the determination of when an option is granted, see §§1.421–1(c) and 1.423–2(h)(2). Any option that does not meet the minimum pricing requirements of this paragraph (g) will not be treated as an option granted under an employee stock purchase plan irrespective of whether the plan or offering satisfies those requirements. If an option that does not meet the minimum pricing requirements is granted to an employee who is entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under such offering that qualifies as an option granted under an employee stock purchase plan, the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421.

(3) The option price may be stated either as a percentage or as a dollar amount. If the option price is stated as a dollar amount, then the requirement of this paragraph (g) can only be met by a plan or of-

fering in which the price is fixed at not less than 85 percent of the fair market value of the stock at the time the option is granted. If the fixed price is less than 85 percent of the fair market value of the stock at grant, then the option cannot meet the requirement of this paragraph (g) even if a decline in the fair market value of the stock results in such fixed price being not less than 85 percent of the fair market value of the stock at the time the option is exercised, because that result was not certain to occur under the terms of the option.

(4) *Examples*. The following examples illustrate the principles of this paragraph (g):

Example 1. Corporation Z has an employee stock purchase plan that provides that the option price will be 85 percent of the fair market value of the stock on the first day of the offering (which is the date of grant in this case), or 85 percent of the fair market value of the stock at exercise, whichever amount is the lesser. Upon the exercise of an option issued under Z's plan, Z agrees to accept an option price that is less than the minimum amount allowable under the terms of such plan. Notwithstanding that the option was issued under an employee stock purchase plan, the transfer of stock pursuant to the exercise of such option does not satisfy the requirement of this paragraph (g) and cannot qualify for the special tax treatment of section 421.

Example 2. Corporation AA has an employee stock purchase plan that provides that the option price is set at 85 percent of the fair market value of AA stock at exercise, but not less than $80 per share. On the first day of the offering (which is the date of grant in this case), the fair market value of AA stock is $100 per share. The option satisfies the requirement of this paragraph (g), and can qualify for the special tax treatment of section 421.

Example 3. Assume the same facts as in *Example 2*, except that the option price is set at 85 percent of the fair market value of AA stock at exercise, but not more than $80 per share. This option cannot satisfy the requirement of this paragraph (g) irrespective of whether, at the time the option is exercised, 85 percent of the fair market value of AA stock is $80 or less.

(h) *Option period*—(1) An employee stock purchase plan or offering must, by its terms, provide that options granted under the plan cannot be exercised after the expiration of 27 months from the date of grant unless, under the terms of the plan or offering, the option price is not less than 85 percent of the fair market value of the stock at the time of the exercise of the option. If the option price is not less than 85 percent of the fair market value of the stock at the time the option is exercised, then the option period provided under the plan must not exceed five years from the date of grant. If the requirements of this paragraph (h) are not met by the terms of the plan or offering, then options issued under such plan or offering will not be treated as options granted under an employee stock purchase plan irrespective of whether the options, by their terms, are exercisable beyond the period allowable under this paragraph (h). An option that provides that the option price is not less than 85 percent of the fair market value of the stock at exercise may have an option period of 5 years irrespective of whether the fair market value of the stock at exercise is more or less than the fair market value of the stock at grant. However, if the option provides that the option price is 85 percent of the fair market value of the stock at exercise, but not more than some other fixed amount determined in accordance with the provisions of paragraph (g) of this section, then irrespective of the price paid on exercise, the option period must not be more than 27 months.

(2) Section 1.421–1(c) provides that, for purposes of §§1.421–1 through 1.424–1, the language "the date of the granting of the option" and the "time such option is granted," and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. With respect to options granted under an employee stock purchase plan, the principles of §1.421–1(c) shall be applied without regard to the requirement that the minimum option price must be fixed or determinable in order for the corporate action constituting an offer of stock to be considered complete.

(3) The date of grant will be the first day of an offering if the terms of an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each employee during the offering. Similarly, the date of grant will be the first day of an offering if the terms of the plan or offering require the application of a formula to establish, on the first day of the offering, the maximum number of shares that may be purchased by each employee during the offering. It is not required that an employee stock purchase plan or offering designate a maximum number of shares that may be purchased by each employee during the offering or incorporate a formula to establish a maximum number of shares that may be purchased by each employee during the offering. If the maximum number of shares that can be purchased under an option is not fixed or determinable until the date the option is exercised, then the date of exercise will be the date of grant of the option.

(4) *Examples*. The following examples illustrate the principles of this paragraph (h):

Example 1. (i) Corporation BB has an employee stock purchase plan that provides that the option price will be the lesser of 85 percent of the fair market value of the stock on the first day of an offering or 85 percent of the fair market value of the stock on the last day of the offering. Options are exercised on the last day of the offering. One million shares of BB stock are reserved for issuance under the plan. The plan provides that no employee may be permitted to purchase stock under the plan at a rate that exceeds $25,000 in fair market value of the BB stock (determined on the date of grant) for each calendar year during which an option granted to the employee is outstanding. The terms of each option granted under an offering provide that a maximum of 500 shares may be purchased by the option recipient during the offering. Because the maximum number of shares that can be purchased under the option is fixed and determinable on the first day of the offering, the date of grant for the option is the first day of the offering.

(ii) Assume the same facts as in paragraph (i) of *Example 1*, except that BB's plan excludes all employees who have been employed less than 18 months. The plan provides that employees who have not yet met the minimum service requirements on the first day of an offering will be granted an option on the date the 18–month service requirement has been attained. With respect to those employees who have been employed less than 18 months on the first day of an offering, the date of grant for the option is the date the 18–month service requirement has been attained.

Example 2. Assume the same facts as in paragraph (i) of *Example 1*, except that the terms of each option granted do not provide that a maximum of 500 shares may be purchased by the option recipient during the offering. Notwithstanding the fixed number of shares reserved for issuance under the plan and the $25,000 limitation set forth in the plan, the maximum number of shares that can be purchased under the option is not fixed or determinable until the last day of the offering when the option is exercised. Therefore the date of grant for the option is the last day of the offering when the option is exercised.

Example 3. Corporation CC has an employee stock purchase plan that provides that the option price will be 85 percent of the fair market value of the stock on the last day of the offering. Options are exercised on the last day of the offering. Each offering under the plan begins on January 1 and ends on December 31 of the same calendar year. The terms of each option granted under an offering provide that the maximum number of shares that may be purchased by any employee during the offering equals $25,000 divided by the fair market value of the stock on the first day of the offering. The maximum number of shares that can be purchased under the option is fixed and deter-

minable on the first day of the offering and therefore the date of grant for the option is the first day of the offering.

Example 4. Assume the same facts as in *Example 3* except that the terms of each option granted under an offering provide that the maximum number of shares that may be purchased by any employee during the offering equals 10 percent of the employee's annual salary (determined as of January 1 of the year in which the offering commences) divided by the fair market value of the stock on the first day of the offering. The maximum number of shares that can be purchased under the option is fixed and determinable on the first day of the offering and therefore the date of grant for the option is the first day of the offering.

(i) *Annual $25,000 limitation*—(1) An employee stock purchase plan or offering must, by its terms, provide that no employee may be permitted to purchase stock under all the employee stock purchase plans of the employer corporation and its related corporations at a rate that exceeds $25,000 in fair market value of the stock (determined at the time the option is granted) for each calendar year in which any option granted to the employee is outstanding at any time. In applying the foregoing limitation—

(i) The right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year;

(ii) The right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed $25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and

(iii) A right to purchase stock that has accrued under one option granted pursuant to the plan may not be carried over to any other option.

(2) If an option is granted under an employee stock purchase plan that satisfies the requirement of this paragraph (i), but the option gives the optionee the right to buy stock in excess of the maximum rate allowable under this paragraph (i), then no portion of the option will be treated as having been granted under an employee stock purchase plan. Furthermore, if the option was granted to an employee entitled to the grant of an option under the terms of the plan or offering, and the employee is not granted an option under the offering that qualifies as an option granted under an employee stock purchase plan, then the offering will not meet the requirements of paragraph (e) of this section. Accordingly, none of the options granted under the offering will be eligible for the special tax treatment of section 421.

(3) The limitation of this paragraph (i) applies only to options granted under employee stock purchase plans and does not limit the amount of stock that an employee may purchase under incentive stock options (as defined in section 422(b)) or any other stock options except those to which section 423 applies. Stock purchased under options to which section 423 does not apply will not limit the amount that an employee may purchase under an employee stock purchase plan, except for purposes of the 5–percent stock ownership provision of paragraph (d) of this section.

(4) Under the limitation of this paragraph (i), an employee may purchase up to $25,000 of stock (based on the fair market value of the stock at the time the option was granted) in each calendar year during which an option granted to the employee under an employee stock purchase plan is outstanding. Alternatively, an employee may purchase more than $25,000 of stock (based on the fair market value of such stock at the time the option was granted) in a calendar year, so long as the total amount of stock that the employee purchases does not exceed $25,000 in fair market value of the stock (determined at the time the option was granted) for each calendar year in which any option was outstanding. If, in any calendar year, the employee holds two or more outstanding options granted under employee stock purchase plans of the employer corporation, or a related corporation, then the employee's purchases of stock attributable to that year under all options granted under employee stock purchase plans must not exceed $25,000 in fair market value of the stock (determined at the time the options were granted). Under an employee stock purchase plan, an employee may not purchase stock in anticipation that the option will be outstanding in some future year. Thus, the employee may purchase only the amount of stock that does not exceed the limitation of this paragraph (i) for the year of the purchase and for preceding years during which the option was outstanding. Thus, the amount of stock that may be purchased under an option depends on the number of years in which the option is actually outstanding. The amount of stock that may be purchased under an employee stock purchase plan may not be increased by reason of the failure to grant an option in an earlier year under such plan, or by reason of the failure to exercise an earlier option. For example, if an option is granted to an individual and expires without having been exercised at all, then the failure to exercise the option does not increase the amount of stock which such individual may be permitted to purchase under an option granted in a year following the year of such expiration. If an option granted under an employee stock purchase plan is outstanding in more than one calendar year, then stock purchased pursuant to the exercise of such an option will be applied first, to the extent allowable under this paragraph (i), against the $25,000 limitation for the earliest year in which the option was outstanding, then, against the $25,000 limitation for each succeeding year, in order.

(5) *Examples*. The following examples illustrate the principles of this paragraph (i):

Example 1. Assume that Corporation DD maintains an employee stock purchase plan and that Employee S is employed by DD. On June 1, 2010, DD grants S an option under the plan to purchase a total of 750 shares of DD stock at $85 per share. On that date, the fair market value of DD stock is $100 per share. The option provides that it may be exercised at any time but cannot be exercised after May 31, 2012. Under this paragraph (i), the option must not permit S to purchase more than 250 shares of DD stock during the calendar year 2010, because 250 shares are equal to $25,000 in fair market value of DD stock determined at the time of grant. During the calendar year 2011, S may purchase under the option an amount of DD stock equal to the difference between $50,000 in fair market value of DD stock (determined at the time the option was granted) and the fair market value of DD stock (determined at the time of grant of the option) purchased during the year 2010. During the calendar year 2012, S may purchase an amount of DD stock equal to the difference between $75,000 in fair market value of the stock (determined at the time of grant of the option) and the total amount of the fair market value of the stock (determined at the time of grant of the option) purchased under the option during the calendar years 2010 and 2011. S may purchase $25,000 of stock for the year 2010, and $25,000 of stock for the year 2012, although the option was outstanding for only a part of each of such years. However, S may not be granted another option under an employee stock purchase plan of DD or a related corporation to purchase stock of DD or a related corporation during the calendar years 2010, 2011, and 2012, so long as the option granted June 1, 2010, is outstanding.

Example 2. Assume the same facts as in *Example 1*, except that the option granted to S in 2010 is terminated in 2011 without any part of the option having been exercised, and that subsequent to the termination and during 2011, S is granted another option under DD's employee stock purchase plan. Under that option, S may be permitted to purchase $25,000 of stock for 2011. The failure of S to exercise the option

granted to S in 2010, does not increase the amount of stock that S may be permitted to purchase under the option granted to S in 2011.

Example 3. Assume the same facts as in *Example 1*, except that, on May 31, 2012, S exercised the option granted to S in 2010, and purchased 600 shares of DD stock. Five hundred shares, the maximum amount of stock that could have been purchased in 2011, under the option, are treated as having been purchased for the years 2010 and 2011. Only 100 shares of the stock are treated as having been purchased for 2012. After S's exercise of the option on May 31, 2012, S is granted another option under DD's employee stock purchase plan. S may be permitted under the new option to purchase for 2012 stock having a fair market value of no more than $15,000 at the time the new option is granted.

Example 4. Corporation EE maintains an employee stock purchase plan and Employee R is employed by EE. On August 1, 2010, EE grants R an option under the plan to purchase 150 shares of EE stock at $85 per share during each of the calendar years 2010, 2011, and 2012. On that date, the fair market value of EE stock is $100 per share. The option provides that it may be exercised at any time during years 2010, 2011, and 2012. Because this option permits R to purchase only $15,000 of EE's stock for each year the option is outstanding, R could be granted another option by EE, or by a related corporation, in year 2010, permitting R to purchase an additional $10,000 of stock during each of the calendar years 2010, 2011, and 2012.

Example 5. Corporation FF maintains an employee stock purchase plan and Employee Q is employed by FF. On September 1, 2010, FF grants Q an option under the plan that will be automatically exercised on August 31, 2011, and August 31, 2012. The terms of the option provide that no more than 150 shares may be purchased on each date that the option is automatically exercised. On August 31, 2011, Q may purchase under the option an amount of FF stock equal to $50,000 in fair market value of FF stock (determined at the time the option was granted). On August 31, 2012, Q may purchase under the option an amount of FF stock equal to the difference between $75,000 in fair market value of FF stock (determined at the time the option was granted) and the fair market value of FF stock (determined at the time of grant of the option) purchased during year 2011.

(j) *Restriction on transferability.* An employee stock purchase plan or offering must, by its terms, provide that options granted under the plan are not transferable by the optionee other than by will or the laws of descent and distribution, and must be exercisable, during the optionee's lifetime, only by the optionee. For general rules relating to the restriction on transferability required by this paragraph (j), see §1.421–1(b)(2). For a limited exception to the requirement of this paragraph (j), see section 424(h)(3).

(k) *Special rule where option price is between 85 percent and 100 percent of value of stock*—(1)(i) If all the conditions necessary for the application of section 421(a) exist, this paragraph (k) provides additional rules that are applicable in cases where, at the time the option is granted, the option price per share is less than 100 percent (but not less than 85 percent) of the fair market value of the share. In that case, upon the disposition of the share by the employee after the expiration of the two-year and the one-year holding periods, or upon the employee's death while owning the share (whether occurring before or after the expiration of such periods), there shall be included in the employee's gross income as compensation (and not as gain upon the sale or exchange of a capital asset) the lesser of—

(a) The amount, if any, by which the price paid under the option was exceeded by the fair market value of the share at the time the option was granted, or

(b) The amount, if any, by which the price paid under the option was exceeded by the fair market value of the share at the time of such disposition or death.

(ii) For purposes of applying the rules of this paragraph (k), if the option price is not fixed or determinable at the time the option is granted, the option price will be computed as if the option had been exercised at such time. The amount of compensation resulting from the application of this paragraph (k) shall be included in the employee's gross income for the taxable year in which the disposition occurs, or for the taxable year closing with the employee's death, whichever event results in the application of this paragraph (k).

(iii) The application of the special rules provided in this paragraph (k) shall not affect the rules provided in section 421(a) with respect to the employee exercising the option, the employer corporation, or a related corporation. Thus, notwithstanding the inclusion of an amount as compensation in the gross income of an employee, as provided in this paragraph (k), no income results to the employee at the time the stock is transferred to the employee, and no deduction under section 162 is allowable at any time to the employer corporation or a related corporation with respect to such amount.

(iv) If, during the employee's lifetime, the employee exercises an option granted under an employee stock purchase plan, but the employee dies before the stock is transferred to the employee pursuant to the exercise of the option, then for the purpose of sections 421 and 423, on the employee's death, the stock is deemed to be transferred immediately to the employee, and immediately thereafter, the employee is deemed to have transferred the stock to the employee's executor, administrator, trustee, beneficiary by operation of law, heir, or legatee, as the case may be.

(2) If the special rules provided in this paragraph (k) are applicable to the disposition of a share of stock by an employee, then the basis of the share in the employee's hands at the time of the disposition, determined under section 1011, shall be increased by an amount equal to the amount includible as compensation in the employee's gross income under this paragraph (k). However, the basis of a share of stock acquired after the death of an employee by the exercise of an option granted to the employee under an employee stock purchase plan shall be determined in accordance with the rules of section 421(c) and §1.421–2(c). If the special rules provided in this paragraph (k) are applicable to a share of stock upon the death of an employee, then the basis of the share in the hands of the estate or the person receiving the stock by bequest or inheritance shall be determined under section 1014, and shall not be increased by reason of the inclusion upon the decedent's death of any amount in the decedent's gross income under this paragraph (k). See *Example (9)* of this paragraph (k) with respect to the determination of basis of the share in the hands of a surviving joint owner.

(3) *Examples.* The following examples illustrate the principles of this paragraph (k):

Example 1. On June 1, 2010, Corporation GG grants to Employee P, an employee of GG, an option under GG's employee stock purchase plan to purchase a share of GG stock for $85. The fair market value of GG stock on such date is $100 per share. On June 1, 2011, P exercises the option and on that date GG transfers the share of stock to P. On January 1, 2013, P sells the share for $150, its fair market value on that date. P's income tax return is filed on the basis of the calendar year. The income tax consequences to P and GG are as follows—

(i) Compensation in the amount of $15 is includible in P's gross income for the year 2013, the year of the disposition of the share. The $15 represents the difference between the option price ($85) and the fair market value of the share on the date the option was granted ($100), because the value is less than the fair market value of the share on the date of disposition ($150). For the purpose of computing P's gain or loss on the sale of the share, P's cost basis of $85 is increased by $15, the amount includible in P's gross

income as compensation. Thus, P's basis for the share is $100. Because the share was sold for $150, P realizes a gain of $50, which is treated as long-term capital gain; and

(ii) GG is not entitled to any deduction under section 162 at any time with respect to the share transferred to P.

Example 2. Assume the same facts as in *Example 1*, except that P sells the share of GG stock on January 1, 2014, for $75, its fair market value on that date. Because $75 is less than the option price ($85), no amount in respect of the sale is includible as compensation in P's gross income for the year 2014. P's basis for determining gain or loss on the sale is $85. Because P sold the share for $75, P realized a loss of $10 on the sale that is treated as a long-term capital loss.

Example 3. Assume the same facts as in *Example 1*, except that the option provides that the option price shall be 90 percent of the fair market value of the stock on the day the option is exercised. On June 1, 2011, when the option is exercised, the fair market value of the stock is $120 per share so that P pays $108 for the share of the stock. Compensation in the amount of $10 is includible in P's gross income for the year 2013, the year of the disposition of the share. This is determined in the following manner: the excess of the fair market value of the stock at the time of the disposition ($150) over the price paid for the share ($108) is $42; and the excess of the fair market value of the stock at the time the option was granted ($100) over the option price, computed as if the option had been exercised at such time ($90), is $10. Accordingly, $10, the lesser, is includible in gross income. In this situation, P's cost basis of $108 is increased by $10, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $118. Because the share was sold for $150, P realizes a gain of $32 that is treated as long-term capital gain.

Example 4. Assume the same facts as in *Example 1*, except that the option provides that the option price shall be the lesser of 95 percent of the fair market value of the stock on the first day of the offering period and 95 percent of the fair market value of the stock on the day the option is exercised. On June 1, 2011, when the option is exercised, the fair market value of the stock is $120 per share. P pays $95 for the share of the stock. Compensation in the amount of $5 is includible in P's gross income for the year 2013, the year of the disposition of the share. This is determined in the following manner: the excess of the fair market value of the stock at the time of the disposition ($150) over the price paid for the share ($95) is $55; and the excess of the fair market value of the stock at the time the option was granted ($100) over the option price, computed as if the option had been exercised at such time ($95), is $5. Accordingly, $5, the lesser, is includible in gross income. In this situation, P's cost basis of $95 is increased by $5, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $100. Because the share was sold for $150, P realizes a gain of $50 that is treated as long-term capital gain.

Example 5. Assume the same facts as in *Example 1*, except that instead of selling the share on January 1, 2013, P makes a gift of the share on that day. In that case $15 is includible as compensation in P's gross income for 2013. P's cost basis of $85 is increased by $15, the amount includible in P's gross income as compensation. Thus, P's basis for the share is $100, which becomes the donee's basis, as of the time of the gift, for determining gain or loss.

Example 6. Assume the same facts as in *Example 2*, except that instead of selling the share on January 1, 2014, P makes a gift of the share on that date. Because the fair market value of the share on that day ($75) is less than the option price ($85), no amount in respect of the disposition by way of gift is includible as compensation in P's gross income for 2014. P's basis for the share is $85, which becomes the donee's basis, as of the time of the gift, for the purpose of determining gain. The donee's basis for the purpose of determining loss, determined under section 1015(a), is $75 (fair market value of the share at the date of gift).

Example 7. Assume the same facts as in *Example 1*, except that after acquiring the share of stock on June 1, 2011, P dies on August 1, 2012, at which time the share has a fair market value of $150. Compensation in the amount of $15 is includible in P's gross income for the taxable year closing with P's death, $15 being the difference between the option price ($85) and the fair market value of the share when the option was granted ($100), because such value is less than the fair market value at date of death ($150). The basis of the share in the hands of P's estate is determined under section 1014 without regard to the $15 includible in the decedent's gross income.

Example 8. Assume the same facts as in *Example 7*, except that P dies on August 1, 2011, at which time the share has a fair market value of $150. Although P's death occurred within one year after the transfer of the share to P, the income tax consequences are the same as in *Example 7*.

Example 9. Assume the same facts as in *Example 1*, except that the share of stock was issued in the names of P and P's spouse jointly with right of survivorship, and that P and P's spouse sold the share on June 15, 2012, for $150, its fair market value on that date. Compensation in the amount of $15 is includible in P's gross income for the year 2012, the year of the disposition of the share. The basis of the share in the hands of P and P's spouse for the purpose of determining gain or loss on the sale is $100, that is, the cost of $85 increased by the amount of $15 includible as compensation in P's gross income. The gain of $50 on the sale is treated as long-term capital gain, and is divided equally between P and P's spouse.

Example 10. Assume the same facts as in *Example 1*, except that the share of stock was issued in the names of P and P's spouse jointly with right of survivorship, and that P predeceased P's spouse on August 1, 2012, at which time the share had a fair market value of $150. Compensation in the amount of $15 is includible in P's gross income for the taxable year closing with his death. See *Example 7*. The basis of the share in the hands of P's spouse as survivor is determined under section 1014 without regard to the $15 includible in the decedent's gross income.

Example 11. Assume the same facts as in *Example 10*, except that P's spouse predeceased P on July 1, 2012. Section 423(c) does not apply in respect of the death of P's spouse. Upon the subsequent death of P on August 1, 2012, the income tax consequences in respect of P's taxable year closing with the date of P's death, and in respect of the basis of the share in the hands of P's estate, are the same as in *Example 7*. If P had sold the share on July 15, 2012 (after the death of P's spouse), for $150, its fair market value at that time, the income tax consequences would be the same as in *Example 1*.

(l) *Effective/applicability date*. The regulations under this section are effective on November 17, 2009. These regulations apply to options granted under an employee stock purchase plan on or after January 1, 2010.

Par. 6. Section 1.424–1, paragraphs (a)(10) *Example 9* (iii) and (g)(1) are revised to read as follows:

§1.424–1 Definition and special rules applicable to statutory options.

(a) * * * (10) * * *

Example 9. * * *

(iii) Assume the same facts as in paragraphs (i) and (ii) of this *Example 9*. Assume further that as part of the acquisition, X amends its plan to allow future grants under the plan to be grants to acquire Y stock. Because the amendment of the plan to allow options on a different stock is considered the adoption of a new plan under §1.422–2(b)(2)(iii), the stockholders of X (in this case, Y) must approve the plan within 12 months before or after the date of the amendment of the plan. If the stockholders of X (in this case, Y) timely approve the plan, the future grants to acquire Y stock will be incentive stock options (assuming the other requirements of §1.422–2 have been met).

* * * * *

(g) *Effective/applicability date*—(1) *In general*. Except for §1.424–1(a)(10) *Example 9* (iii), the regulations under this section are effective on August 3, 2004. Section 1.424–1(a)(10) *Example 9* (iii) is effective on November 17, 2009. Section 1.424–1(a)(10) *Example 9* (iii) applies to statutory options granted on or after January 1, 2010.

* * * * *

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

Approved November 9, 2009.

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

(Filed by the Office of the Federal Register on November 16, 2009, 8:45 a.m., and published in the issue of the Federal Register for November 17, 2009, 74 F.R. 59074)

Section 424.—Definitions and Special Rules

Final regulations clarify the shareholder approval requirements related to incentive stock options under section 422. See T.D. 9471, page 722.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 807.—Rules for Certain Reserves

The adjusted federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 810.—Operations Loss Deduction

Guidance is provided for taxpayers to elect a 4 or 5 year carryback of losses from operations under section 13 of the Worker, Homeownership, and Business Assistance Act of 2009. See Rev. Proc. 2009-52, page 744.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

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

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

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

Rev. Rul. 2009–38

This revenue ruling provides various prescribed rates for federal income tax purposes for December 2009 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before December 31, 2013, shall not be less than 9%. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the 2010 interest rate for sections 846 and 807.

REV. RUL. 2009–38 TABLE 1

Applicable Federal Rates (AFR) for December 2009

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	.69%	.69%	.69%	.69%
110% AFR	.76%	.76%	.76%	.76%
120% AFR	.83%	.83%	.83%	.83%
130% AFR	.90%	.90%	.90%	.90%
Mid-term				
AFR	2.64%	2.62%	2.61%	2.61%
110% AFR	2.90%	2.88%	2.87%	2.86%
120% AFR	3.16%	3.14%	3.13%	3.12%
130% AFR	3.44%	3.41%	3.40%	3.39%
150% AFR	3.97%	3.93%	3.91%	3.90%
175% AFR	4.64%	4.59%	4.56%	4.55%
Long-term				
AFR	4.17%	4.13%	4.11%	4.09%
110% AFR	4.59%	4.54%	4.51%	4.50%
120% AFR	5.02%	4.96%	4.93%	4.91%
130% AFR	5.44%	5.37%	5.33%	5.31%

REV. RUL. 2009–38 TABLE 2

Adjusted AFR for December 2009

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	.86%	.86%	.86%	.86%
Mid-term adjusted AFR	2.25%	2.24%	2.23%	2.23%
Long-term adjusted AFR	4.14%	4.10%	4.08%	4.07%

REV. RUL. 2009–38 TABLE 3

Rates Under Section 382 for December 2009

Adjusted federal long-term rate for the current month	4.14%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.16%

REV. RUL. 2009–38 TABLE 4

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

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

Appropriate percentage for the 70% present value low-income housing credit	7.79%
Appropriate percentage for the 30% present value low-income housing credit	3.34%

REV. RUL. 2009–38 TABLE 5	
Rate Under Section 7520 for December 2009	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	3.2%

REV. RUL. 2009–38 TABLE 6	
Rates Under Sections 846 and 807	
Applicable rate of interest for 2010 for purposes of sections 846 and 807	3.81%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Section 6039.—Returns Required in Connection With Certain Options

Final regulations provide guidance to assist corporations that issue statutory stock options in complying with the return and information statement requirements under section 6039. See T.D. 9470, page 738.

26 CFR 1.6039–1: Returns required in connection with certain options.

T.D. 9470

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR part 1

Information Reporting Requirements Under Internal Revenue Code Section 6039

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains the final regulations relating to the return and information statement requirements under section 6039 of the Internal Revenue Code (Code). These regulations reflect changes to section 6039 made by section 403 of the Tax Relief and Health Care Act of 2006. These regulations affect corporations that issue statutory stock options and provide guidance to assist corporations in complying with the return and information statement requirements under section 6039.

DATES: *Effective Date:* These regulations are effective on November 17, 2009.

Applicability Date: For dates of applicability, *see* §§1.6039–1(f) and 1.6039–2(e).

FOR FURTHER INFORMATION CONTACT: Thomas Scholz or Ilya Enkishev at (202) 622–6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these 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 1545–2129. Responses to this collection of information are required to assist taxpayers with the completion of their income tax returns for the taxable year in which a disposition of stock acquired under a statutory option occurs.

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

Section 403 of the Tax Relief and Health Care Act of 2006 (Act) amended the information reporting requirements of section 6039. Prior to its amendment, section 6039 required corporations to furnish a written statement to each employee, in a manner prescribed by the Secretary in the regulations, regarding: (i) the corporation's transfer of stock pursuant to the employee's exercise of an incentive stock option described in section 422(b); and (ii) the transfer of stock by the employee where the stock was acquired pursuant to the exercise of an option described in section 423(c). Corporations must furnish employees with the information statements required by section 6039 on or before January 31 of the year following the year for which the statement is required. Prior to the amendment of section 6039 made by the Act, the regulations under section 6039 were last updated in 2004. See T.D. 9144, 2004–2 C.B. 413 (69 FR 46401).

As amended by the Act, section 6039 requires corporations to file an information return with the IRS, in addition to providing employees with an information statement, following a stock transfer. Section 6039, as amended by the Act, applies to stock transfers occurring on or after January 1, 2007. However, in Notice 2008–8, 2008–3 I.R.B. 276 (December 19, 2007) (see §601.601(d)(2)(ii)(*b*)), the IRS waived the obligation to file an information return for 2007 stock transfers governed by section 6039.

On July 17, 2008, the Department of Treasury published a notice of proposed rulemaking (REG–103146–08,

2008–37 I.R.B. 701) in the **Federal Register** (73 FR 40999) under section 6039. In addition to describing the return and information reporting requirements pursuant to section 6039, the notice of proposed rulemaking waived the obligation to file an information return for 2008 stock transfers governed by section 6039. A public hearing on the proposed regulations was held on October 30, 2008. Written and electronic comments responding to the notice of proposed rulemaking were received. After consideration of these comments, the Department of Treasury adopts the proposed regulations as final regulations, with the modifications set forth in this Treasury decision. The significant revisions are discussed in this preamble.

Explanation of Provisions

1. Overview

These final regulations describe the information that is required in the return filed with the IRS and the information statement furnished to employees pursuant to section 6039. There are two sections under these final regulations: §1.6039–1, Returns required in connection with certain options; and §1.6039–2, Statements to persons with respect to whom information is reported. A principal objective of these final regulations is to require corporations to furnish employees with sufficient information to enable them to calculate their tax obligations upon disposition of the shares acquired by the exercise of a statutory option. As discussed further in this preamble, the IRS will issue two forms (with accompanying instructions) that corporations must use to satisfy the return and information statement requirements under section 6039.

Comments received in response to the proposed regulations were generally favorable. Commenters observed that the proposed regulations improved the existing regulations by requiring corporations to provide additional information useful to employees for purposes of computing tax liability with respect to the disposition of shares acquired pursuant to the exercise of a statutory option. These final regulations are generally similar to the proposed regulations with the modifications described below in response to the comments submitted by taxpayers.

2. Return and information statement requirements for stock acquired pursuant to incentive stock options

With respect to the transfer of stock pursuant to the exercise of an incentive stock option, the information required in the return and the information statement pursuant to §1.6039–1(a) and §1.6039–2(a) of these final regulations is the same information that is required pursuant to the proposed regulations.

3. Return and information statement requirements for stock acquired under employee stock purchase plans

a. Transfers of legal title for stock acquired under an employee stock purchase plan

Section 6039(a)(2) requires every corporation which records (or has by its agent recorded) a transfer of the legal title of a share of stock acquired by the employee where the stock was acquired pursuant to the exercise of an option described in section 423(c) to file a return with respect to each transfer made during a particular year. Section 6039(c)(2) provides that the return under section 6039(a)(2) is required only with respect to the first transfer of such stock by the person who exercised the option. Section 6039(b) requires every corporation filing a return under section 6039(a)(2) to furnish to each employee named in such return a written statement with respect to the transfer or transfers made by the employee during a particular year.

Several commenters noted that it has become common practice for employers to maintain a system in which shares acquired by employees under an employee stock purchase plan are deposited directly into a brokerage account established on behalf of the employee. In the typical arrangement, a contractual agreement exists with a recognized broker or financial institution, and employees who elect to participate in the employee stock purchase plan direct that all shares acquired upon the exercise of the option be immediately deposited into a brokerage account established on behalf of the employee. The legal title of the shares deposited into the brokerage account is typically held by another entity acting as a securities depository, which holds the shares in the street name of the broker. The employee has a beneficial interest in the shares, but the securities depository holds legal title of the shares.

The final regulations modify §1.6039–1(b)(3) of the proposed regulations to provide that a transfer of legal title to a recognized broker or financial institution immediately following the exercise of an option is treated as the first transfer of legal title for purposes of the section 6039(a)(2) filing requirement. Accordingly, if an employer operates an employee stock purchase plan pursuant to which shares acquired upon exercise of the option will be immediately deposited into a brokerage account established on behalf of the employee, then the deposit of shares by the employee into the brokerage account following the exercise of the option is the first transfer of legal title of the shares acquired by the employee and the corporation is only required to file a return relating to such transfer of legal title.

For employees whose shares are immediately deposited into a brokerage account following the exercise of an option, the exercise of the option and the first transfer of legal title occur on the same date. In such a case, the dates to be provided under §§1.6039–1(b)(1)(vii) (the date the option was exercised) and (ix) (the date legal title was first transferred) will be the same.

If, instead of establishing a brokerage arrangement, an employer either issues a stock certificate directly to an employee who purchases stock pursuant to an employee stock purchase plan, or registers the shares in the employee's name on the employer's record books and the employer or its transfer agent holds the shares for the employee in book-entry form, then, for purposes of section 6039(a)(2) and (c)(2), the issuance of the stock certificate or the registration of the stock ownership on the record books is not considered the first transfer of legal title of the stock acquired by the employee. Accordingly, the employer is not required to file a return and furnish an information statement to the employee (pursuant to section 6039(a)(2) and (b)) with respect to such transfer of the stock to the employee. Instead, the employer is required to file a return and furnish an information statement to the em-

ployee with respect to the first transfer of the legal title of the stock acquired by the employee (for example, when the employee sells the stock or transfers the stock to a brokerage account established on behalf of the employee). Consequently, if a stock certificate is issued or the ownership of the shares is registered on the employer's record books following the exercise of an option, the exercise of the option and the first transfer of legal title occur on different dates, unless the shares are immediately sold or otherwise transferred. Accordingly, in such a case, the dates to be provided under §§1.6039–1(b)(1)(vii) (the date the option was exercised) and (ix) (the date legal title was first transferred) will be different.

b. Reporting of information with respect to the special tax rule under section 423(c)

Acknowledging that one of the primary purposes of these regulations is to provide information to employees for purposes of computing their tax liability with respect to the disposition of shares acquired pursuant to statutory options, commenters suggested that the return and information statement provided with respect to options granted under an employee stock purchase plan contain additional information necessary to calculate the tax liability in the case of a qualifying disposition of the stock. Under section 423(a), a qualifying disposition occurs if the stock acquired under an employee stock purchase plan is disposed of no earlier than two years after the date of grant of the option and one year after the date of exercise of the option.

Section 423(c) provides a special rule for calculating the timing and amount of compensation income that must be recognized in the event of a qualifying disposition when the exercise price is less than 100 percent of the value of a share on the date of grant. Generally, the compensation income recognized is the lesser of: (a) the excess of the fair market value of the share on the date of grant over the exercise price, and (b) the excess of the fair market value of a share at the time of disposition (or death) over the price paid per share. The flush language of section 423(c) provides that if the exercise price is not known on the date of grant, the exercise price shall be determined as if the option were exercised on the date of grant.

There are various circumstances under which the exercise price will not be known on the date of grant. For example, the exercise price will not be known on the date of grant if the exercise price is equal to the lesser of 85 percent of the fair market value of the stock on the date of grant or 85 percent of the fair market value of the stock on the date of exercise. In addition, the exercise price will not be known on the date of grant if the exercise price is calculated based on a certain percentage (not less than 85 percent) of the fair market value of the stock on the date of exercise. In order to compute the tax liability resulting from a qualifying disposition of the stock acquired using either of the foregoing pricing formulas, the employee needs to know the exercise price determined as if the option were exercised on the date of grant of the option.

In response to the comments, these final regulations modify the proposed regulations by adding §1.6039–1(b)(vi) to these final regulations. If the exercise price per share of an option is not fixed or determinable on the date the option was granted to the employee, §1.6039–1(b)(vi) of these final regulations requires corporations to include in the return and information statement the exercise price per share determined as if the option were exercised on the date of grant.

c. Requirement of return and information statement under section 6039(a)(2) and (b)

Commenters asked for clarification regarding whether the return and information statement requirements of section 6039(a)(2) and (b) apply only to the transfer of shares pursuant to a qualifying disposition. Section 6039(a)(2) requires that an information return be filed by every corporation which in any calendar year records (or has by its agent recorded) a transfer of the legal title of a share of stock acquired by the transferor pursuant to his or her exercise of an option described in section 423(c). The IRS and the Treasury Department have concluded that the reference in section 6039(a)(2) to an option described in section 423(c) relates to the exercise price of the option (as evidenced by the parenthetical phrase in section 6039(a)(2) following the reference to section 423(c)) rather than whether or not the shares are disposed of in a qualifying disposition as also described in section 423(c). Furthermore, section 6039(c)(2) provides that the return and information statement requirements of section 6039(a)(2) and (b) are triggered by the first transfer of the legal title of the shares. This provision would be unnecessary if section 6039(a)(2) only applied to qualifying dispositions. Therefore, these final regulations provide that the return and information statement requirements are not dependent upon whether such transfer of legal title is a qualifying or disqualifying disposition.

Commenters also asked for clarification regarding whether the return and information statement requirements of section 6039(a)(2) and (b) only apply to the transfer of shares acquired pursuant to an option described in section 423(c) where the exercise price is less than 100 percent of the value of a share on the date of grant. These final regulations provide that the return and information statement requirements of section 6039(a)(2) and (b) also apply to the transfer of shares acquired pursuant to an option where the exercise price is not fixed or determinable on the date of grant, as well as to the transfer of shares acquired pursuant to an option described in section 423(c) where the exercise price is less than 100 percent of the value of a share on the date of grant.

4. Nonresident aliens

Several commenters suggested that the return and information statement requirements of section 6039 should not apply to nonresident aliens (as defined in section 7701(b)) who perform services outside the United States. These commenters point out that the reported information may not be useful to nonresident aliens because they likely will not have any U.S. tax liability.

In response to comments, these final regulations modify the proposed regulations by adding §1.6039–1(e) which provides an exception to the return requirements of section 6039(a) for certain nonresident aliens. With respect to incentive stock options, the return requirement of section 6039(a)(1) is not applicable to the exercise of an incentive stock option by an employee who is a nonresident alien and to whom the corporation is not required

to provide a Form W–2, *Wage and Tax Statement* (or its designated successor) for any calendar year within the time period beginning with the first day of the calendar year in which the option was granted to the employee and ending on the last day of the calendar year in which the employee exercised the incentive stock option. With respect to employee stock purchase plans, the return requirement of section 6039(a)(2) is not applicable to the first transfer of legal title of a share of stock by an employee who is a nonresident alien and to whom the corporation is not required to provide a Form W–2 for any calendar year within the time period beginning with the first day of the calendar year in which the option was granted to the employee and ending on the last day of the calendar year in which the employee first transferred legal title to shares acquired under the option. For purposes of §1.6039–1(e) of these final regulations, the term *corporation* is defined in section 7701(a) and includes, but is not limited to, the corporation issuing the stock, a related corporation of the corporation, any agent of the corporation, any party distributing shares of stock or other payments in connection with the plan (for example, a brokerage firm), and any party in control of the payment of remuneration for employment to the employee.

5. Forms to satisfy the return and information statement requirements

Returns required by §1.6039–1(a) of these final regulations and information statements required by §1.6039–2(a) of these final regulations must be made using Form 3921, *Exercise of an Incentive Stock Option Under Section 422(b)* (or its designated successor) and filed in the manner provided in the instructions thereto. Returns required by §1.6039–1(b) of these final regulations and information statements required by §1.6039–2(b) of these final regulations must be made using Form 3922, *Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)* (or its designated successor) and filed in the manner provided in the instructions thereto. Section 1.6039–1(c) of the proposed regulations provided that Forms 3921 and 3922 must be filed on or before January 31 of the year following the year for which the return and statement are required. Section 1.6039–1(c) of these final regulations has been revised to provide that Forms 3921 and 3922 must be filed in accordance with the guidelines and procedures set forth in the instructions to Forms 3921 and 3922. The IRS expects to release Forms 3921 and 3922 in the near future.

Several commenters suggested that taxpayers be allowed to satisfy the information statement requirements of §1.6039–2(a) and (b) of these final regulations by delivering a substitute form that includes all of the information required to be included on the Forms 3921 or 3922, as applicable. Taxpayers may satisfy the return requirements of §1.6039–1(a) and (b) as well as the information statement requirements of §1.6039–2(a) and (b) by submitting substitute Forms 3921 and 3922 in accordance with the guidelines set forth in Publication 1179 (or its designated successor). For example, it would be permissible for a taxpayer to satisfy the return requirements of §1.6039–1(a) and (b) by submitting Forms 3921 and 3922 to the IRS, and satisfy the information statement requirements of §1.6039–2(a) and (b) by delivering substitute Forms 3921 and 3922 to the appropriate recipients in accordance with the guidelines set forth in Publication 1179 (or its designated successor).

Effective/Applicability Date

These final regulations will apply as of January 1, 2007. However, taxpayers are not required to comply with the return requirements of §1.6039–1(a) and (b) of these final regulations for stock transfers that occur during the 2007, 2008 and 2009 calendar years. Notwithstanding the waiver of the return requirements for 2007, 2008 and 2009 stock transfers, taxpayers must furnish information statements to employees for such stock transfers. For purposes of furnishing information statements for stock transfers that occur during the 2007 or 2008 calendar years, taxpayers may rely on §1.6039–1 of the 2004 final regulations ((69 FR 46401) or §1.6039–2 of the 2008 proposed regulations (REG–103146–08)) (73 FR 40999). For purposes of furnishing information statements for stock transfers that occur during the 2009 calendar year, taxpayers may rely on §1.6039–1 of the 2004 final regulations (69 FR 46401), §1.6039–2 of the 2008 proposed regulations (REG–103146–08) (73 FR 40999), or these final regulations.

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 is hereby certified that the regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the filing of a return with the IRS and the provision of employee statements required under this Treasury decision will impose a minimal administrative burden on small entities. It is estimated that it will take approximately 30 minutes to prepare and provide the information required by these regulations. Further, the information to be provided is readily available. Therefore, an analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Thomas Scholz and Ilya Enkishev, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6039–1 is revised to read as follows:

§1.6039–1 Returns required in connection with certain options.

(a) *Requirement of return with respect to incentive stock options under section 6039(a)(1).* (1) Every corporation which in any calendar year transfers to any person a share of stock pursuant to such person's exercise of an incentive stock option shall, for such calendar year, file a return with respect to each transfer made during such year. This return must include the following information—

(i) The name, address, and employer identification number of the corporation transferring the stock;

(ii) If other than the corporation identified in paragraph (a)(1)(i) of this section, the name, address and employer identification number of the corporation whose stock is being transferred;

(iii) The name, address, and identifying number of the person to whom the share or shares of stock were transferred pursuant to the exercise of the option;

(iv) The date the option was granted to the person;

(v) The exercise price per share;

(vi) The date the option was exercised by the person;

(vii) The fair market value of a share of stock on the date the option was exercised by the person; and

(viii) The number of shares of stock transferred to the person pursuant to the exercise of the option.

(2) Each return required by this paragraph (a) shall be made on Form 3921, *Exercise of an Incentive Stock Option Under Section 422(b)* (or its designated successor) and shall be filed in such manner as provided in the instructions thereto.

(b) *Requirement of return with respect to stock purchased under an employee stock purchase plan under section 6039(a)(2).* (1) Every corporation which in any calendar year records, or has by its agent recorded, a transfer of the legal title of a share of stock acquired by the transferor (person who acquires the shares pursuant to the exercise of the option) pursuant to the transferor's exercise of an option granted under an employee stock purchase plan as described in section 423(c) and where the exercise price is less than 100 percent of the value of the stock on date of grant or is not fixed or determinable on the date of the grant, shall, for such calendar year, file a return with respect each transfer made during such year. This return must include the following information—

(i) The name, address, and identifying number of the transferor;

(ii) The name, address and employer identification number of the corporation whose stock is being transferred;

(iii) The date the option was granted to the transferor;

(iv) The fair market value of the stock on the date the option was granted;

(v) The actual exercise price paid per share;

(vi) The exercise price per share determined as if the option were exercised on the date the option was granted to the transferor (to be provided only if the exercise price per share is not fixed or determinable on the date the option was granted);

(vii) The date the option was exercised by the transferor;

(viii) The fair market value of the stock on the date the option was exercised by the transferor;

(ix) The date the legal title of the shares was transferred by the transferor (see paragraph (b)(3) of this section); and

(x) The number of shares to which legal title was transferred by the transferor.

(2) Each return required by this paragraph (b) shall be made on Form 3922, *Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)* (or its designated successor) and shall be filed in such manner as provided in the instructions thereto.

(3) A return is required by reason of a transfer described in section 6039(a)(2) only with respect to the first transfer of legal title of the shares by the transferor, including the first transfer of legal title to a recognized broker or financial institution. If a contractual agreement exists or is entered into with a recognized broker or financial institution pursuant to which shares acquired upon exercise of the option will be immediately deposited into a brokerage account established on behalf of the transferor, then the deposit of shares by the transferor into the brokerage account following the exercise of the option is the first transfer of legal title of the shares acquired by the transferor, and the corporation is only required to file a return relating to such transfer of legal title.

(4) Every corporation that transfers any share of stock pursuant to the exercise of an option described in this paragraph shall identify such stock in a manner sufficient to enable the accurate reporting of the transfer of legal title to such shares. Such identification may be accomplished by assigning to the certificates of stock issued pursuant to the exercise of such options a special serial number or color.

(c) *Time for filing returns.* Each return required by this section for a calendar year must be filed in accordance with the guidelines and procedures set forth in the instructions to Form 3921 and Form 3922.

(d) *Penalty.* For provisions relating to the penalty applicable to the failure to file a return under this section, see section 6721.

(e) *Exception to return requirements of section 6039(a) for certain nonresident aliens—* (1) *Return requirement under section 6039(a)(1).* The return requirement of section 6039(a)(1) is not applicable to the exercise of an incentive stock option by an employee who is a nonresident alien (as defined in section 7701(b)) and to whom the corporation is not required to provide a Form W–2, *Wage and Tax Statement* (or its designated successor) for any calendar year within the time period beginning with the first day of the calendar year in which the option was granted to the employee and ending on the last day of the calendar year in which the employee exercised the option.

(2) *Return requirement under section 6039(a)(2).* The return requirement of section 6039(a)(2) is not applicable to the first transfer of legal title of a share of stock by an employee who is a nonresident alien (as defined in section 7701(b)) and to whom the corporation is not required to provide a Form W–2 for any calendar year within the time period beginning with the first day of the calendar year in which the option was granted to the employee and ending on the last day of the calendar year in which the employee first transferred legal title to shares acquired under the option as described in paragraph (b)(3) of this section.

(3) For purposes of this paragraph (e), the term *corporation* is defined in section 7701(a) and includes, but is not limited to, the corporation issuing the stock, a related corporation of the corporation, any agent of the corporation, any party distributing shares of stock or other payments in con-

nection with the plan (for example, a brokerage firm), and any party in control of the payment of remuneration for employment to the employee.

(f) *Effective/applicability date*—(1) *In general*. This section is effective on November 17, 2009. This section will apply as of January 1, 2007.

(2) *Transition period*. Taxpayers are not required to comply with the return requirements of paragraphs (a) and (b) of this section for stock transfers that occur during the 2007, 2008 and 2009 calendar years.

Par. 3. A new §1.6039–2 is added to read as follows:

§1.6039–2 Statements to persons with respect to whom information is reported.

(a) *Requirement of statement with respect to incentive stock options under section 6039(b).* (1) Every corporation filing a return under §1.6039–1(a) shall furnish to each person whose name is set forth in such return a written statement with respect to the transfer or transfers made to such person during such year. This statement must include the information described in §1.6039–1(a)(1).

(2) Each statement required by this paragraph (a) to be furnished to any person must be furnished to such person on Form 3921, *Exercise of an Incentive Stock Option Under Section 422(b)* (or its designated successor) and be delivered at such time and in such manner as provided in the instructions thereto.

(b) *Requirement of statement with respect to stock purchased under an employee stock purchase plan under section 6039(b).* (1) Every corporation filing a return under §1.6039–1(b) shall furnish to each person whose name is set forth in such return a written statement with respect to the transfer or transfers made by such person during such year. This statement must include the information described in §1.6039–1(b)(1).

(2) Each statement required by this paragraph (b) to be furnished to any person must be furnished to such person on Form 3922, *Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)* (or its designated successor) and be delivered at such time and in such manner as provided in the instructions thereto.

(3) If the statement required by this paragraph is made by the authorized transfer agent of the corporation, it is deemed to have been made by the corporation. The term *transfer agent*, as used in this section, means any designee authorized to keep the stock ownership records of a corporation and to record a transfer of title of the stock of such corporation on behalf of such corporation.

(c) *Time for furnishing statements*—(1) *In general*. Each statement required by this section to be furnished to any person for a calendar year must be furnished to such person on or before January 31 of the year following the year for which the statement is required.

(2) *Extension of time*. An extension of time to furnish statements required by this section may be granted in accordance with the guidelines and procedures set forth in the instructions to Form 3921 and Form 3922.

(d) *Penalty*. For provisions relating to the penalty applicable to the failure to furnish a statement under this section, see section 6722.

(e) *Effective/applicability date*—(1) *In general*. This section is effective on November 17, 2009. This section will apply as of January 1, 2007.

(2) *Reliance and transition period*. Notwithstanding §1.6039–1(f), corporations must furnish information statements to employees in accordance with this section for stock transfers that are subject to §1.6039–1(a) and (b), and occur during the 2007, 2008 and 2009 calendar years. For purposes of furnishing information statements for stock transfers that occur during the 2007 or 2008 calendar years, taxpayers may rely on §1.6039–1 of the 2004 final regulations (69 FR 46401) or §1.6039–2 of the 2008 proposed regulations (REG–103146–08) (73 FR 40999). For purposes of furnishing information statements for stock transfers that occur during the 2009 calendar year, taxpayers may rely on §1.6039–1 of the 2004 final regulations (69 FR 46401), §1.6039–2 of the 2008 proposed regulations (REG–103146–08) (73 FR 40999), or this section.

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

Approved November 9, 2009.

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

(Filed by the Office of the Federal Register on November 16, 2009, 8:45 a.m., and published in the issue of the Federal Register for November 17, 2009, 74 F.R. 59087)

Section 6411.—Tentative Carryback and Refund Adjustments

Guidance is provided for taxpayers to elect the 3, 4, or 5 year carryback of net operating losses or losses from operations under section 13 of the Worker, Homeownership, and Business Assistance Act of 2009 by filing Form 1045, *Application for Tentative Refund*, or Form 1139, *Corporation Application for Tentative Refund*. See Rev. Proc. 2009-52, page 744.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2009. See Rev. Rul. 2009-38, page 736.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 172, 6411.)

Rev. Proc. 2009–52

SECTION 1. PURPOSE

.01 This revenue procedure provides guidance under § 13 of the Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111–92, 123 Stat. 2984 (November 6, 2009) (the Act). Section 13 of the Act amends §§ 172(b)(1)(H) and 810(b) of the Internal Revenue Code to allow taxpayers to elect to carry back an applicable net operating loss (NOL) for a period of 3, 4, or 5 years, or a loss from operations for 4 or 5 years, to offset taxable income in those preceding taxable years. This revenue procedure applies to losses from operations of a life insurance company under § 810 in the same manner as to NOLs under § 172.

.02 This revenue procedure prescribes when and how to elect under § 172(b)(1)(H) to carry back an applicable NOL for a period of 3, 4, or 5 years for (1) taxpayers that have not claimed a deduction for an applicable NOL; (2) taxpayers that previously claimed a deduction for an applicable NOL; and (3) taxpayers that previously filed an election under §§ 172(b)(3) or 810(b)(3) to forgo the NOL carryback period.

SECTION 2. BACKGROUND

.01 Section 172(a) allows a deduction equal to the aggregate of the NOL carryovers and carrybacks to the taxable year. Section 172(b)(1)(A)(i) provides that an NOL for any taxable year generally must be carried back to each of the 2 years preceding the taxable year of the NOL. Section 172(b)(3) provides that any taxpayer entitled to a carryback period under § 172(b)(1) may make an irrevocable election to relinquish the carryback period for an NOL for any taxable year.

.02 Section 810(b)(1)(A) provides that life insurance companies may carry back an NOL for any taxable year to each of the 3 years preceding the taxable year of the loss. Section 810(b)(3) provides that any taxpayer entitled to a carryback period under § 810(b)(1) may make an irrevocable election to relinquish the carryback period for a loss from operations for any taxable year.

.03 Section 6411(a) provides that a taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by an NOL carryback from any taxable year. Section 6411(a) also provides that the application must be filed on or after the date of filing for the return for the taxable year of the NOL from which the carryback results and within a period of 12 months after that taxable year or, for any portion of a business credit carryback attributable to an NOL from a subsequent taxable year, within a period of 12 months from the end of the subsequent taxable year. Section 6411(b) provides a 90-day period during which the Internal Revenue Service will make a limited examination of the application to discover omissions and errors of computation and determine the amount of the decrease in tax attributable to the carryback. The Service may disallow, without further action, any application that contains errors of computation that cannot be corrected within the 90-day period or that contains material omissions. The decrease in tax attributable to the carryback is applied against unpaid amounts of tax. Any remainder of the decrease is credited or refunded within the 90-day period.

.04 Section 1211 of the American Recovery and Reinvestment Tax Act of 2009, Div. B of Pub. L. No. 111–5, 123 Stat. 115 (February 17, 2009) (ARRA), amended § 172(b)(1)(H) to allow an eligible small business (ESB) to elect to carry back a 2008 applicable NOL for a period of 3, 4, or 5 years (the ARRA election). Unlike the § 172(b)(1)(H) election under the Act (referred to in this revenue procedure as the § 172(b)(1)(H) election), the ARRA election is applicable only to an NOL attributable to an ESB. The ARRA election is irrevocable and may be made for only one taxable year. Rev. Proc. 2009–26, 2009–19 I.R.B. 935 (April 25, 2009), modifying and superseding Rev. Proc. 2009–19, 2009–14 I.R.B. 747 (March 16, 2009), advises taxpayers how to make the ARRA election.

.05 Section 172(b)(1)(H)(i), as amended by the Act, permits a taxpayer to elect to carry back its applicable NOL to 3, 4, or 5 years preceding the taxable year of the applicable NOL. This election is not limited to an ESB. Section 172(b)(1)(H)(ii) provides that the term "applicable net operating loss" means the taxpayer's NOL for a taxable year ending after December 31, 2007, and beginning before January 1, 2010.

.06 Section 172(b)(1)(H)(iii) provides that the election under § 172(b)(1)(H) is required to be made in a manner prescribed by the Secretary, and must be made by the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009. The election is irrevocable and, in general, may be made for only one taxable year. However, § 172(b)(1)(H)(v) allows a taxpayer that made or makes an ARRA election also to make an election under § 172(b)(1)(H) for another taxable year.

.07 Section 172(b)(1)(H)(iv) limits the amount of an NOL that a taxpayer elects under § 172(b)(1)(H)(i) to carry back to the 5th taxable year preceding the taxable year of the loss to 50 percent of the taxpayer's taxable income for the carryback taxable year. The taxable income for the carryback taxable year is computed without regard to the NOL for the loss year or any taxable year thereafter. The excess of the amount of the loss over 50 percent of the taxable income, as determined under § 172(b)(2), for the carryback taxable year is carried to later taxable years. For the carryback of an alternative tax NOL to the 5th taxable year preceding the taxable year of the loss, the 50 percent limitation is applied separately based on the alternative minimum taxable income. The § 172(b)(1)(H)(iv) limitation does not apply to an NOL carryback under the ARRA election.

.08 Section 13(e)(4) of the Act provides that a taxpayer that has elected under §§ 172(b)(3) or 810(b)(3) to forgo a carryback for a loss for a taxable year ending before the date of enactment of the Act (November 6, 2009) may revoke that election before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009. An application under § 6411(a) for

the applicable NOL is treated as timely if filed before that due date.

.09 Section 13(c) of the Act amends § 810(b) to allow life insurance companies to elect to carry back an applicable loss from operations for 4 or 5 taxable years. An applicable loss from operations is a loss from operations for a taxable year ending after December 31, 2007, and beginning before January 1, 2010.

.10 Section 13(f) of the Act provides that § 172(b)(1)(H) does not apply to any taxpayer that received certain benefits (whether or not repaid) under the Emergency Economic Stabilization Act of 2008, Title I of Div. A of Pub. L. No. 110–343, 122 Stat. 3765 (TARP recipients), or to members of the taxpayer's affiliated group.

SECTION 3. SCOPE

Except as provided in § 13(f) of the Act, this revenue procedure applies to taxpayers that incurred an applicable NOL or an applicable loss from operations for a taxable year ending after December 31, 2007, and beginning before January 1, 2010.

SECTION 4. APPLICATION

.01 *Time and manner of making the election under § 172(b)(1)(H).*

(1) *In general.* A taxpayer within the scope of this revenue procedure may make the election under § 172(b)(1)(H) or § 810(b)(4) by following the procedure described in either section 4.01(3) or section 4.01(4) of this revenue procedure. The procedures under this revenue procedure that apply to NOLs and the election under § 172(b)(1)(H) also apply to a loss from operations of a life insurance company and the election under § 810(b)(4).

(2) *Affiliated groups.* For purposes of this revenue procedure, "taxpayer" includes an affiliated group filing a consolidated return, "applicable NOL" includes a consolidated net operating loss (CNOL), and the common parent of the group makes the § 172(b)(1)(H) election. See § 1.1502–21(b); § 1.1502–77(a). However, nothing in this revenue procedure permits a consolidated return group to otherwise make or revoke a carryback waiver election for the CNOL attributable to a member acquired from another group, described in § 1.1502–21(b)(3)(ii)(B). The conditions under which this election may be permitted will be the subject of separate guidance.

(3) *Electing on a federal income tax return for the taxable year of the applicable NOL.*

(a) *What to file.* A taxpayer may make the election under § 172(b)(1)(H) by attaching a statement to the taxpayer's federal income tax return for the taxable year in which the applicable NOL arises. A taxpayer that filed its federal income tax return for the taxable year of the applicable NOL may make the election by attaching a statement to an amended return for the taxable year of the applicable NOL. The election statement must state that the taxpayer is electing to apply § 172(b)(1)(H) or § 810(b)(4) under Rev. Proc. 2009–52, and that the taxpayer is not a TARP recipient nor, in 2008 or 2009, an affiliate of a TARP recipient. The statement must specify the length of the NOL carryback period the taxpayer elects (3, 4, or 5 years).

(b) *When to file.* A taxpayer must file the election statement with the taxpayer's original or amended federal income tax return for the taxable year of the applicable NOL on or before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009.

(c) *Carryback applications or refund claims.* A taxpayer that makes the § 172(b)(1)(H) election under this section 4.01(3) must attach a copy of the election statement to the taxpayer's claim for tentative carryback adjustment (Form 1045, *Application for Tentative Refund*; or Form 1139, *Corporation Application for Tentative Refund*) or amended return applying the applicable NOL to the carryback year. The due date for timely filing a claim for tentative carryback adjustment on Form 1045 or 1139 for a taxpayer that makes the § 172(b)(1)(H) election is extended to the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009.

(4) *Electing on an appropriate form.* In lieu of the procedures described in section 4.01(3) of this revenue procedure, a taxpayer may make the § 172(b)(1)(H) election on an appropriate form under this section 4.01(4).

(a) *What to file.*

(i) A taxpayer may make the § 172(b)(1)(H) election by attaching an election statement to the appropriate form the taxpayer files applying the NOL carryback period the taxpayer elects. The election statement must state that the taxpayer is electing to apply § 172(b)(1)(H) or § 810(b)(4) under Rev. Proc. 2009–52, and that the taxpayer is not a TARP recipient nor, in 2008 or 2009, an affiliate of a TARP recipient. The statement must specify the length of the NOL carryback period the taxpayer elects (3, 4, or 5 years). The appropriate form is—

(A) For corporations, Form 1139 or Form 1120X, *Amended U.S. Corporation Income Tax Return*;

(B) For individuals, Form 1045 or Form 1040X, *Amended U.S. Individual Income Tax Return*;

(C) For estates or trusts, Form 1045 or amended Form 1041, *U.S. Income Tax Return for Estates and Trusts*.

(D) For tax exempt organizations with unrelated business income, Form 1139 or amended Form 990–T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*.

(b) *When to file.* When using an appropriate form to make the election under this paragraph 4.01(4), the taxpayer must file the form on or before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009. The taxpayer's time for claiming a tentative carryback adjustment on Form 1045 or 1139 also is extended to this date.

.02 *Taxpayers that previously filed a carryback application or claim.*

(1) *In general.* A taxpayer that previously filed an application for a tentative carryback adjustment (whether or not the Service has acted upon the application) or an amended return (except to the extent that the application or claim was for an applicable NOL for which an ESB made an ARRA election) may make the election under § 172(b)(1)(H) by following the procedures under section 4.01(3) or (4) of this revenue procedure. The taxpayer's election statement must state that the election amends a previous carryback application or claim.

(2) *Additional rules.* A taxpayer's amendment of a carryback application or claim also applies to a carryback of any alternative tax NOL for the same taxable year. In the case of an amended application for a tentative carryback adjustment, the 90-day period described in § 6411(b)

begins on the date the taxpayer files the amended application.

.03 *Revocation of the election to waive NOL carryback period*. A taxpayer within the scope of this revenue procedure that previously elected under § 172(b)(3) or § 810(b)(3) to forgo the carryback period for an applicable NOL for a taxable year ending before November 6, 2009, may revoke that election and make the election under § 172(b)(1)(H). Any revocation of the election to forgo the NOL carryback period also will apply to a carryback of any alternative tax NOL for the same taxable year. The taxpayer may make the revocation and the election by following the procedures under section 4.01(3) or (4) of this revenue procedure. The election statement must state that the taxpayer is revoking an NOL (or loss from operations) carryback waiver and electing to apply § 172(b)(1)(H) or § 810(b)(4) under Rev. Proc. 2009–52, and that the taxpayer is not a TARP recipient nor, in 2008 or 2009, an affiliate of a TARP recipient. The statement must specify the length of the NOL carryback period the taxpayer elects (3, 4, or 5 years). The taxpayer must file the revocation and the election under § 172(b)(1)(H) before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for NOLs arising in taxable years ending after December 31, 2007.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the following control numbers: 1545–0074 Form 1040 (*U.S. Individual Income Tax Return*) and Form 1040X (*Amended U.S. Individual Income Tax Return*); 1545–0123 Form 1120 (*U.S. Corporation Income Tax Return*); 1545–0132 Form 1120X (*Amended U.S. Corporation Income Tax Return*); 1545–0128 Form 1120–L (*U.S. Life Insurance Company Income Tax Return*); 1545–0092 Form 1041 (*U.S. Income Tax Return for Estates and Trusts*); 1545–0687 Form 990–T (*Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*); 1545–0098 Form 1045 (*Application for Tentative Refund*); 1545–0582 Form 1139 (*Corporation Application for Tentative Refund*). For further information, please refer to the Paperwork Reduction Act statements accompanying these forms.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Seoyeon Park and Forest Boone of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Park or Mr. Boone at (202) 622–4960 (not a toll-free call).

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26 CFR 31.6053–1: Report of tips by employee to employer.

Rev. Proc. 2009–53

SECTION 1. PURPOSE

The purpose of this revenue procedure is to extend the Attributed Tip Income Program (ATIP) for two additional years. The requirements for participating in ATIP are set forth in Rev. Proc. 2006–30, 2006–2 C.B. 110.

SECTION 2. BACKGROUND

.01 ATIP is a reporting alternative for employers in the food and beverage industry designed to promote compliance by employers and employees with the provisions of the Internal Revenue Code governing tip income, to reduce disputes on audit, and to reduce filing and recordkeeping burdens.

02. Rev. Proc. 2006–30 established ATIP as a pilot program available for the three calendar years beginning on or after January 1, 2007. The Service has determined that the ATIP pilot program should be extended.

SECTION 3. EXTENSION OF ATIP

Section 11.02 of Rev. Proc. 2006–30 provides that ATIP will sunset on December 31, 2009. This revenue procedure extends ATIP for two additional years. ATIP will now terminate on December 31, 2011, unless the Service issues further guidance extending the term. Notwithstanding the foregoing, the Commissioner of Internal Revenue may terminate ATIP at any time.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2006–30 is modified to extend ATIP for two additional years. With the exception of this extension, requirements for ATIP as set forth in Rev. Proc. 2006–30 remain unchanged.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective immediately.

SECTION 6. PAPERWORK REDUCTION ACT

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number. This revenue procedure does not impose any new information collection. The Office of Management and Budget (OMB) previously approved the information collection requirements contained in Rev. Proc. 2006–30 under control number 1545–2005.

The collection of information is in Rev. Proc. 2006–30, section 4, titled Employer Participation in ATIP. This information is required to evaluate the suitability of the Reporting Program for the particular taxpayer. The collection of information is required to obtain the benefits described in Rev. Proc. 2006–30. The likely respondents are businesses or other for-profit institutions.

SECTION 7. CONTACT INFORMATION

The principal author of this revenue procedure is Linda L. Conway of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding ATIP, contact the IRS Business and Specialty Tax Line at (800) 829–4933 or e-mail *Tip.Program@irs.gov*.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Information Reporting for Payments Made in Settlement of Payment Card and Third Party Network Transactions

REG–139255–08

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to information reporting requirements, information reporting penalties, and backup withholding requirements for payment card and third party network transactions. The proposed regulations reflect the enactment of section 6050W and related changes in the law made by the Housing Assistance Tax Act of 2008 that require payment settlement organizations to report payments in settlement of payment card and third party network transactions for each calendar year. The proposed regulations in this document will affect persons that make payment in settlement of payment card and third party network transactions and the payees of these transactions. The proposed regulations provide guidance to assist persons who will be required to make returns reporting payment card and third party network transactions and to the payees of those transactions. This document also provides notice of a public hearing on these proposed amendments to the regulations.

DATES: Written or electronic comments must be received by January 25, 2010. Outlines of topics to be discussed at the public hearing scheduled for February 10, 2010 at 10 am must be received by January 27, 2010.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–139255–08), 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–139255–08), 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–139255–08).

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Barbara Pettoni, (202) 622–4910; concerning submissions of comments or the public hearing, Regina Johnson, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR Part 1 relating to information reporting under sections 6041, 6050W, and 6051 of the Internal Revenue Code (Code). This document also contains proposed amendments to 26 CFR Part 31 relating to backup withholding under section 3406, and to 26 CFR Part 301 relating to information reporting penalties under sections 6721 and 6722.

A new reporting requirement, section 6050W, was added to the Code by section 3091(a) of the Housing Assistance Tax Act of 2008, Div. C of Public Law No. 110–289, 122 Stat. 2654 (the Act), enacted on July 30, 2008. Section 6050W requires merchant acquiring entities and third party settlement organizations to file an information return for each calendar year reporting all payment card transactions and third party network transactions with participating payees occurring in that calendar year. This requirement to file information returns applies to returns for calendar years beginning after December 31, 2010. This section also requires statements to be furnished to participating payees on or before January 31st of the year following the year for which the return is required.

The Act also amended section 3406(b)(3) to provide that amounts reportable under section 6050W are subject to backup withholding requirements. Section 3406(a)(1) requires certain payors to perform backup withholding by deducting and withholding income tax from a reportable payment (as defined in section 3406(b)(1)) if the payee fails to furnish the payee's taxpayer identification number (TIN) to the payor on a required return, or if the Secretary notifies the payor that the TIN furnished by the payee is incorrect. Backup withholding for amounts reportable under section 6050W applies to amounts paid after December 31, 2011.

Prior to making an information return, a payor may check the TIN furnished by the payee against the name/TIN combination contained in the IRS's database maintained for the program, and the IRS will inform the participant whether or not the name/TIN combination furnished by the payee matches a name/TIN combination in the database. The matching information provided to participants will help avoid TIN errors and reduce the number of backup withholding notices required under section 3406(a)(1)(B) of the Code. A verified TIN/name match will also provide participants with reasonable cause relief from penalties under section 6724(a). The Act further provides that, solely for purposes of carrying out TIN matching under section 3406, section 6050W is effective on the date of enactment, July 30, 2008. The TIN matching program described in Rev. Proc. 2003–9, 2003–1 C.B. 516, permits program participants to verify the payee TINs required to be reported on information returns and payee statements. On February 6, 2009, the IRS announced that persons who will be required to make returns under section 6050W may match TINs under the procedures established by Rev. Proc. 2003–9. See Announcement 2009–6, "Taxpayer Identification Number ("TIN") Matching Program is Available to Persons Required to Make Returns Under New Section 6050W of the Internal Revenue Code" (Announcement 2009–6, 2009–9 I.R.B. 643 (March 2, 2009)). See §601.601(d)(2)(ii)(*b*).

The Act also amended section 6724(d) by adding returns required by section 6050W to the definition of information return for purposes of penalties for failure to comply with certain information reporting requirements. The amendments to section

6724(d) apply to returns for calendar years beginning after December 31, 2010.

Notice 2009–19 invited public comments regarding guidance under section 6050W. See Notice 2009–19, "Information Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions" (Notice 2009–19, 2009–10 I.R.B. 660 (March 9, 2009)). In particular, Notice 2009–19 requested comments on the interpretation of the statutory definitions of terms used in section 6050W, how to administer the reporting requirements so as to prevent reporting of the same transaction more than once, and whether the "gross amount" of the reportable payment transaction should be defined as "gross receipts or sales" or whether adjustments should be made for credits, cash equivalents, discounts, fees, refunds, or other amounts. Notice 2009–19 also requested comments on how to address differences between section 6050W reporting and payee reporting on Form 1040, *"U.S. Individual Income Tax Return,"* Form 1065, *"U.S. Return of Partnership Income,"* or Form 1120, *"U.S. Corporation Income Tax Return,"* and whether the time, form and manner of reporting should conform to existing practices for information reporting to the IRS under other provisions of the Code.

Comments were received in response to Notice 2009–19, and the comments were taken into consideration in developing these proposed regulations. The IRS and the Treasury Department invite any additional comments on the issues discussed in this preamble or on other issues relating to section 6050W. See §601.601(d)(2)(ii)(*b*).

Explanation of Provisions

In general

The proposed regulations provide guidance to interpret the definitions used in the statute and examples to illustrate the rules in the proposed regulations. The new law requires any payment settlement entity making payment to a participating payee in settlement of reportable payment transactions to make an annual return for each calendar year reporting the gross amount of the reportable transactions, and the name, address, and TIN of the participating payee. See section 6050W(a). The law also requires payment settlement entities to furnish written statements to persons with respect to whom such a return is required showing the name, address, and telephone number of the information contact of the person required to make the return and the gross amount of the reportable payment transactions with respect to the person required to be shown on the return. See section 6050W(f).

Section 6050W(b) provides that the term *payment settlement entity* means, in the case of a payment card transaction, a merchant acquiring entity; and in the case of a third party network transaction, a third party settlement organization. Section 6050W(b)(2) defines *merchant acquiring entity* as the bank or other organization with the contractual obligation to make payment to participating payees in settlement of payment card transactions, and section 6050W(b)(3) defines *third party settlement organization* as the central organization that has the contractual obligation to make payment to participating payees of third party network transactions. The proposed regulations clarify that a "payment settlement entity" may be a domestic or foreign entity.

A *reportable payment transaction* is any transaction in which a payment card is accepted as payment and any transaction that is settled through a third party payment network. See section 6050W(c). The proposed regulations provide guidance to interpret the meaning of this term in the context of both payment card transactions and third party network transactions, and to determine the gross amount of the transaction to be reported. Many commenters suggested meanings for the term "gross amount." Some commenters suggested defining "gross amount" as the total amount of the transaction reduced by the fees deducted by the merchant acquiring entity. Other commenters suggested defining "gross amount" as the total amount of the transaction reduced by not only fees but also chargebacks and refunds. Commenters did not suggest, however, that reporting a gross amount with no reductions for any amounts would be burdensome for payment settlement entities. The proposed regulations provide that *gross amount* means the total dollar amount of aggregate reportable payment transactions for each participating payee without regard to any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts, or any other amounts.

The proposed regulations require reporting, with respect to each participating payee, of the gross amount of the aggregate reportable payment transactions for the calendar year and the gross amount of the aggregate reportable payment transactions for each month of the calendar year. The inclusion of monthly amounts on the return filed with the IRS and on the statement furnished to the payee will aid in reconciling payment card and third party network transaction receipts for fiscal year payees.

Section 6050W(e) provides an exception for *de minimis* payments by third party settlement organizations to certain participating payees. Under the proposed regulations, a third party settlement organization must report payments made to a participating payee only if its aggregate payments to that payee from third party network transactions exceed $20,000 and the aggregate number of those transactions with the payee exceeds 200. Several commenters requested that the exception for *de minimis* payments be extended to include payments in settlement of payment card transactions. The proposed regulations do not adopt this suggestion. Further comments are requested on the application of the *de minimis* rule exception, including whether the exception should be mandatory or voluntary.

Section 6050W(d)(1)(A) provides that *participating payee* means: (i) in the case of a payment card transaction, any person who accepts a payment card as payment; and (ii) in the case of a third party network transaction, any person who accepts payment from a third party settlement organization in settlement of such transaction. Under section 6050W(d)(1)(B), the term *participating payee* excludes any person with a foreign address, except as the Secretary may provide. The proposed regulations provide that a payment settlement entity that is a person described as a U.S. payor or U.S. middleman in §1.6049–5(c)(5) is not required to report payments to participating payees with a foreign address as long as, prior to payment, the payee has provided the payment settlement entity with documentation upon which the payment settlement entity may rely to treat the payment as made to a foreign person in accordance with

§1.1441–1(e)(1)(ii). By contrast, a payment settlement entity that is not a person described as a U.S. payor or U.S. middleman in §1.6049–5(c)(5) is not required to report payments to participating payees that do not have a United States address as long as the payment settlement entity neither knows nor has reason to know that the participating payee is a United States person. For purposes of this section, *foreign address* means any address that is not within the United States, as defined in section 7701(a)(9) (the States and the District of Columbia). *United States address* means any address that is within the United States. The IRS and the Treasury Department request comments on the treatment of payment settlement entities that are not U.S. payors or U.S. middlemen within the meaning of §1.6049–5(c)(5).

Under section 6050W(d)(1)(C), the term "participating payee" includes any governmental unit and any agency or instrumentality thereof. Accordingly, the proposed regulations do not provide for any exceptions to reporting for payments made to governmental units. Payments to governmental units that are made using transit cards and electronic toll collection systems are included within the scope of section 6050W if such payments meet the other requirements of section 6050W. Comments were not received from governmental units regarding these issues. Therefore, the IRS and the Treasury Department request comments from governmental units and other interested parties regarding the impact of these proposed regulations on governmental units that accept payments made using transit cards, electronic toll collection systems, and similar electronic payment mechanisms.

Payment Card Transactions

A *payment card transaction* is any transaction in which a payment card is accepted as payment. See section 6050W(c)(2). Under section 6050W(d)(2), a *payment card* is a card issued pursuant to an agreement or arrangement that provides for: (1) one or more issuers of such cards; (2) a network of persons unrelated to each other, and to the issuer, who agree to accept the cards as payment; and (3) standards and mechanisms for settling the transactions between the merchant acquiring entities and the persons who agree to accept the cards as payment.

Funds generally do not pass directly from the cardholder to the provider of goods or services for purchases made with a payment card. For example, in the case of a credit card transaction, a credit card organization may direct the transfer of funds from an issuing bank (the bank that issued the credit card) through the debit of the funds on account at an acceptable institution (such as a Federal Reserve Bank) and a credit of those funds to the merchant's bank (the merchant acquiring bank), which in turn pays the provider of goods or services. The cardholder frequently does not pay the issuing bank until after receipt of the payment card monthly billing statement. Thus, the merchant acquiring bank makes the payment to the provider of goods or services to settle the transaction, and the cardholder, who is the ultimate payor, generally does not make payment until after the transaction occurs. The information reporting requirements under section 6050W reflect that the merchant acquiring bank is in the best position to file the information return reporting the payment to the provider of goods or services.

Commenters suggested adopting the definition of "payment card" in §31.3406(g)–1(f)(2)(i) for purposes of section 6050W. However, the definition of "payment card" in section 6050W(d)(2) is broader than in §31.3406(g)–1(f)(2)(i), which defines *payment card* as a card issued by a payment card organization (for example, a credit card organization). The proposed regulations reflect the broader statutory definition of "payment card" under section 6050W. Accordingly, a payment card is a card, issued to a cardholder, that a network of unrelated persons has agreed to accept as payment under an agreement that provides standards and mechanisms for settling the transactions between a merchant acquiring bank or similar entity and the providers who accept the cards. Under the proposed regulations, a payment card includes, but is not limited to, all credit cards, debit cards, and stored-value cards (including gift cards), and also includes the acceptance as payment of any account number or other indicia associated with a payment card.

Cards Issued in Connection with a Flexible Spending Account or a Health Reimbursement Arrangement

Several commenters requested that the definition of *payment card* be interpreted to exclude cards issued in connection with flexible spending arrangements (FSAs) (as defined in section 106(c)(2)) or health reimbursement arrangements (HRAs) that are treated as employer-provided coverage under an accident or health plan for purposes of section 106. The commenters expressed concern that section 6050W may be interpreted to override the exception to information reporting under section 6041(f) for payments made for medical care (as defined in section 213(d)) under FSAs and HRAs. Other commenters indicated that it would be difficult for merchant acquiring entities to identify FSA and HRA card transactions and segregate them from other payment card transactions. In general, FSA and HRA cards have the imprint of a credit card association and function like credit or debit cards. Therefore, merchant acquiring entities may have difficulty distinguishing these transactions from typical credit or debit card transactions. In keeping with the broad interpretation of the definition of "payment card," the proposed regulations do not except payments for medical care using an FSA or HRA card from reporting under section 6050W. Therefore, under the proposed regulations, the definition of payment card encompasses a card issued in connection with an FSA or HRA. Payments made for medical care under FSAs or HRAs will continue to be exempt from reporting under section 6041.

Stored-Value Cards and Gift Cards

The proposed regulations provide that the term "stored-value card" means any card with a prepaid value, including any gift card. Under the proposed regulations, a stored-value card is not a payment card within the meaning of section 6050W when the card is accepted as payment by a person who is related to the issuer of the card. Under these circumstances, the transaction is not a payment card transaction within the meaning of section 6050W and thus not a reportable transaction. However, if the stored-value card itself is purchased with a payment card issued by

an unrelated entity, that purchase transaction is reportable under section 6050W.

In contrast, a stored-value card that a network of persons unrelated to the issuer has agreed to accept as payment (such as a stored-value card issued by a college that may be used at various local merchants unrelated to the college) is a payment card when it is accepted as payment in a transaction with an unrelated person. Under these circumstances, the transaction is a payment card transaction within the meaning of section 6050W that is reportable by the payment settlement entity. Use of a stored-value card within a network of both related persons and unrelated persons is a reportable transaction only when it is accepted as payment by an unrelated person. For purposes of this section, *unrelated* means any person who is not related within the meaning of section 267(b) (providing a list of relationships), including the application of section 267(c) and (e)(3) (providing rules relating to constructive ownership), or section 707(b)(1) (relationships with partnerships).

Third Party Network Transactions

Section 6050W(c)(3) provides that a *third party network transaction* means any transaction that is settled through a third party payment network. Section 6050W(d)(3) provides that *third party payment network* means any agreement or arrangement that: (A) involves the establishment of accounts with a central organization by a substantial number of persons who (i) are unrelated to such organization, (ii) provide goods or services, and (iii) have agreed to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement; (B) provides for standards and mechanisms for settling such transactions; and (C) guarantees persons providing goods or services pursuant to such agreement or arrangement that those persons will be paid for providing such goods or services. Section 6050W(d)(3) provides that a third party payment network does not include any agreement or arrangement that provides for the issuance of payment cards.

The Joint Committee on Taxation (JCT) technical explanation of section 6050W explains that, in the case of a third party network transaction, the payment settlement entity is the third party settlement organization, defined as a central organization with the contractual obligation to make payment to participating payees of third party payment networks. According to the technical explanation, the central organization is a payment settlement entity required to report under section 6050W if it provides "a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payments through the network." See "Technical Explanation of Division C of H.R. 3221, the 'Housing Assistance Act of 2008' as Scheduled for Consideration by the House of Representatives on July 23, 2008" (JCX–63–08), *Joint Committee on Taxation*, at 61 (July 23, 2008) (JCT Technical Explanation). Consistent with this explanation, the proposed regulations provide that the central organization of a third party settlement organization must provide a third party payment network that enables purchasers to transfer funds to providers of goods and services.

The JCT Technical Explanation also gives an example of "substantial number of persons" as that phrase is used in the definition of "third party payment network" in section 6050W(d)(3). The JCT Technical Explanation describes a "third party payment network" as any agreement or arrangement that, among other requirements, involves the establishment of accounts with a central organization by "a substantial number of persons (*e.g.*, more than 50)." JCT Technical Explanation at 61. Comments are requested on the interpretation of "substantial number of persons" as used in the definition of "third party payment network."

Many comments were received requesting clarification on the meaning of third party payment network, in particular with respect to healthcare networks, accounts payable departments and "shared-service" organizations, and organizations that settle payment transactions on behalf of others.

Healthcare Networks

Several commenters expressed concern that the broad definition of third party payment network will include health carriers that have contracts with a network of providers who provide services to covered persons under both insured and administrative service contract healthcare arrangements. A typical healthcare network (sometimes referred to as a "managed care" network) may include "covered persons" (policyholders, subscribers, enrollees or other individuals participating in a health benefit plan), a "health care provider" or "participating provider" (a healthcare professional or a facility that agrees under contract with a health carrier to provide services to covered persons with the expectation of receiving payment directly from the health carrier), and a "health carrier" (an entity that enters into an agreement to provide, deliver, arrange for, pay for, or reimburse any of the cost of health care services). Each of these parties may be a primary party with respect to its agreements with the other parties in the network.

Under the proposed regulations, health carriers operating a healthcare network are outside the scope of section 6050W because a healthcare network does not enable the transfer of funds from buyers to sellers. Health carriers do not facilitate the transfer of payments from a covered person to a healthcare provider: the payments by covered persons to health carriers and the payments by health carriers to healthcare providers are separate and distinct. Health carriers collect premiums from covered persons pursuant to a plan agreement between the health carrier and the covered person for the cost of participation in the healthcare network. Separately, health carriers pay healthcare providers to compensate providers for services rendered to covered persons pursuant to provider agreements. Accordingly, because the purpose of a healthcare network is not to enable buyers to transfer funds to sellers, a healthcare network is not a "third party payment network" within the meaning of the proposed regulations.

Accounts Payable Departments and Shared-Service Organizations

Many comments were received requesting guidance on the interpretation of "third party payment network" with respect to accounts payable departments. Under the proposed regulations, an in-house accounts payable department is not a third party settlement organization of a third party payment network because an in-house accounts payable department is

not a "third party." Rather, an in-house accounts payable department is merely an accounting function of the purchaser of goods and services by which the purchaser makes payments directly to sellers on the purchaser's own behalf.

In contrast, many purchasers outsource their accounts payable function to a third party organization, sometimes referred to as a "shared-service" organization. In a shared-service business model, the shared-service organization acts as an independent contractor with respect to the accounts payable of purchasers of goods and services. A shared-service arrangement allows purchasers to transfer funds to providers who have established accounts with the shared-service organization and have agreed to accept payment for their goods and services from the shared-service organization. Thus, the shared-service business model consists of a central organization that provides "a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payments through the network." JCT Technical Explanation at 61.

Accordingly, under the proposed regulations, a shared-service organization is a third party settlement organization of a third party payment network if: (1) a substantial number of unrelated providers of goods and services have established accounts with the shared-service organization, and (2) this arrangement enables purchasers of goods and services to transfer funds to these providers, who are obligated by contract to accept guaranteed payments from the shared-service organization in settlement of their transactions with the purchasers. The shared service organization must report these transactions as third party network transactions unless the *de minimis* exception applies (that is, the aggregate payments to each payee do not exceed $20,000 or the aggregate number of transactions for each payee does not exceed 200).

Automated Clearing House (ACH) Networks

As stated previously, the JCT Technical Explanation states that an organization generally is required to report if it provides "a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payment through the network." JCT Technical Explanation at 61. The JCT Technical Explanation further states: "However, an organization operating a network which merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers, but does not have contractual agreements with sellers to use such network, is not required to report under the provision." JCT Technical Explanation at 61.

Consistent with the JCT Technical Explanation, an example in the proposed regulations illustrates that payments settled through an automated clearing house (ACH) network are not settled through a third party payment network. An ACH merely processes electronic payments between payors and payees, and does not itself have contractual agreements with payees to use the ACH network. Accordingly, the proposed regulations reflect that an ACH network is not a third party payment network, and an ACH is therefore not required to report under section 6050W.

Aggregated Payees

Section 6050W(b)(4)(A) imposes special rules for persons who receive payments from a payment settlement entity on behalf of one or more participating payees and distribute such payments to one or more participating payees. Under section 6050W(b)(4)(A), such persons are treated (i) as participating payees with respect to the payment settlement entity, and (ii) as payment settlement entities with respect to the participating payees to whom the person distributes payments.

For example, in the case of a corporation that receives payment from a bank for credit card sales transacted at corporate independently-owned franchise stores, the bank is required to report the gross amount of the reportable transactions settled through the corporation even though the corporation does not accept credit cards and would not otherwise be treated as a participating payee under this section. In turn, the corporation is required to report the gross amount of reportable transactions allocable to each franchise store. The bank has no obligation to report the payments allocated by the corporation to the franchise stores. See Technical Explanation at 61–62. The proposed regulations provide an example of persons that are aggregated payees for purposes of this section. This example is not meant to exclude other aggregated payee arrangements.

Electronic Payment Facilitators

A payment settlement entity may contract with a third party to settle reportable payment transactions on behalf of the payment settlement entity. Section 6050W(b)(4)(B) provides a special rule for such arrangements. In any case where an "electronic payment facilitator" or other third party makes payments in settlement of reportable payment transactions on behalf of the payment settlement entity, the return under section 6050W must be filed by the electronic payment facilitator or other third party in lieu of the payment settlement entity.

Under the proposed regulations, any person that has contracted with a payment settlement entity to make payments on behalf of the payment settlement entity to a participating payee in settlement of reportable payment transactions is subject to the electronic payment facilitator rule. Because the electronic payment facilitator or other third party is required by statute to file the return if it makes the payment on behalf of the payment settlement entity, and because the electronic payment facilitator or other third party files in lieu of the payment settlement entity, the payment facilitator or other third party, not the payment settlement entity, is the party with the obligation to file the return under section 6050W in these cases. Therefore, the electronic payment facilitator or other third party that makes payment on behalf of the payment settlement entity is the party that will be liable for any applicable penalties for failure to comply with the information reporting requirements under section 6050W.

Duplicate Reporting of the Same Transaction

Section 6050W(g) grants authority to the Secretary to issue guidance to implement the reporting requirement, including rules to prevent the reporting of the same transaction more than once. Numerous

commenters requested relief from reporting the same transaction under more than one Code section, in particular with respect to transactions that will be subject to reporting under both sections 6041 (relating to information at source) and 6050W.

Depending on the circumstances, reporting of the same transaction more than once may be warranted for several reasons. First, the burden for reporting may fall on different persons. For example, under section 6041, the reporting person is the payor, whereas under section 6050W, the reporting person is the payment settlement entity. Requiring reporting from both reporters will help ensure that the transaction is reported even where one reporter fails to report.

Second, information reporting under other Code sections may provide different information that may be useful to the IRS. For example, section 6041 requires reporting of fixed or determinable gains, profits and income, whereas section 6050W requires reporting of gross amounts.

Third, exceptions to information reporting may apply under one Code section but not the other, which makes rules to avoid reporting the same transaction more than once difficult to coordinate. For example, §1.6041–3(p) provides that payments made to corporations are generally exempt from reporting under section 6041, whereas no corporate payee exception exists under section 6050W. Conversely, for third party network transactions under section 6050W, a *de minimis* exception applies where the aggregate payments to each payee do not exceed $20,000 or the aggregate number of transactions for each payee does not exceed 200, but no similar exception exists under section 6041. Thus, there are compelling reasons to require reporting under both Code sections.

Nevertheless, for payment card transactions, relief from reporting under section 6041 is warranted because section 6050W reporting covers all payment card transactions and thus effectively encompasses all payments subject to section 6041 reporting made by payment card. Accordingly, the proposed regulations amend section §1.6041–1 to provide that any payment card transaction that otherwise would be reportable under both sections 6041 and 6050W must be reported under section 6050W and not section 6041.

Relief from reporting under section 6041 is not warranted, however, for third party network transactions because such transactions are not subject to reporting unless the *de minimis* thresholds are met. The payor with the obligation to report under section 6041 cannot determine with certainty whether a third party network transaction is required to be reported under section 6050W. Additional comments are requested regarding the application of this rule to prevent the reporting of the same transaction more than once.

Commenters also requested relief from reporting the same transaction under both sections 3402(t) (relating to withholding on certain payments made by government entities) and 6050W. Government entities frequently use payment cards for payments for property and services. Such payment card transactions will be subject both to information reporting under section 6050W and to withholding and information reporting under section 3402(t).

Information reporting under section 3402(t) and section 6050W serve different purposes, however. The purpose of information reporting under section 6050W is to encourage voluntary compliance in the reporting of gross receipts. In contrast, the purpose of information reporting under section 3402(t) is to report the amounts of tax withheld from payments and to furnish this information to payees and to the IRS. Both payees and the IRS must have mechanisms in place to account for the income tax that has been withheld from payments. Therefore, reporting under section 3402(t) cannot be eliminated for transactions that will also be required to be reported under section 6050W.

Further, an exception from reporting under section 6050W when the same transaction will be reported under section 3402(t) is not feasible because the payment settlement entity, such as a merchant acquiring entity in the case of a payment card transaction, may not have access to the identity of the actual card user. Thus, the payment settlement entity would not know whether the card user is a government entity required to withhold on payments pursuant to section 3402(t) and would not be able to determine whether reporting under section 6050W is excepted. Also, the proposed rules under section 3402(t) provide for a $10,000 payment threshold amount, whereas section 6050W has no payment threshold amount for payment card transactions. See REG–158747–06, 2009–4 I.R.B. 362 (73 FR 74,082) (Dec. 5, 2008). Accordingly, the proposed regulations do not provide relief from reporting the same transaction under both sections 3402(t) and 6050W.

Time, Form and Manner for Reporting

Many commenters recommended that the IRS create a new form to be used solely for reporting under section 6050W. A draft form for this purpose, Form 1099–K, "*Merchant Card and Third-Party Payments*," is expected to be released contemporaneously with these proposed regulations. Draft Form 1099–K will be available for viewing and comment on the IRS web site at *http://www.irs.gov/pub/irs-dft/f1099k—dft.pdf*. Additional guidance regarding the proper form for reporting under this section will be issued in time for filing the first returns due under this section (returns for calendar year 2011 due in 2012).

The draft form is expected to require reporting, with respect to each participating payee, of the gross amount of the aggregate reportable payment transactions for the calendar year and the gross amount of the aggregate reportable payment transactions for each month of the calendar year. The inclusion of monthly amounts on the return filed with the IRS and on the statement furnished to the payee will aid in reconciling payment card and third party network transaction receipts for fiscal year payees. Additionally, the proposed regulations provide that the time and manner for reporting under section 6050W will follow the existing procedures for information reporting under other Code sections.

Section 6050W(f) provides that payee statements may be furnished electronically. Commenters requested that the existing procedures for payee statements be modified to eliminate the requirement for an affirmative consent to receive the payee statement under section 6050W electronically. Instead, commenters requested that merchants already receiving business communications electronically be deemed to have consented to receive electronic payee statements under section 6050W. Commenters also suggested that reporting entities not be required to send a separate communication to payees to inform them

of their option to receive payee statements electronically; rather, the communication may be included in another business communication. Commenters also suggested that merchants receiving paper communications who wish to receive electronic payee statements be allowed to consent to electronic payees statements by logging onto a website to indicate their consent, with no further written consent required. The proposed regulations do not adopt these suggestions to eliminate the existing consent procedures for furnishing electronic statements to payees. Additional comments are requested on whether the existing consent procedures should be modified.

Backup Withholding

The Act amended section 3406(b)(3) to provide that reportable payment transactions subject to information reporting under section 6050W generally are subject to backup withholding requirements. Section 3406 requires backup withholding in the case of any reportable payment if a condition for backup withholding, as set forth in section 3406(a)(1), exists. In the case of reportable payments, backup withholding generally applies if the payee fails to furnish his TIN to the payor or if the IRS notifies the payor that the TIN furnished by the payee is incorrect.

Section 3091(c) of the Act amended section 3406(b) by expanding the meaning of reportable payments subject to backup withholding to include payments required to be shown on a return required under section 6050W, effective for amounts paid after December 31, 2011. Accordingly, the proposed regulations amend the regulations under section 3406 to provide that persons making information returns with respect to any reportable payment under section 6050W made after December 31, 2011 are included in the definition of "payors" obligated to backup withhold.

Several commenters expressed concern that when backup withholding for reportable payments reportable under section 6050W becomes effective, duplicate backup withholding on the same payment could potentially occur. The same reportable payment may be reportable under section 6050W and under another Code section, such as section 6041 or 6041A, thus potentially subjecting the payee to as much as 56-percent withholding for the same transaction.

Because the proposed regulations provide relief from reporting under section 6041 for payment card transactions that would otherwise be reportable under both sections 6041 and 6050W, the potential for duplicate backup withholding in such situations is eliminated. There continues, however, to be a potential for duplicate backup withholding for reportable payments made after December 31, 2011 that are reportable under section 6050W and another Code section. Also, in the case of a payment for services using a third party payment network after December 31, 2011, the payment potentially could be subject to backup withholding by the payor for these services as a reportable payment under section 6041, and by the third party settlement organization as a reportable payment under section 6050W.

A payment settlement entity reporting under section 6050W is in a better position to perform backup withholding for a third party network transaction than the payor reporting under section 6041. Backup withholding compliance is difficult for payors in third party network transactions because an invoice may not be issued, and the payor in the transaction may not be in a position to backup withhold easily at the time of the transaction. Backup withholding may also be difficult because the payor does not make payment directly to the provider of services; rather, the third party settlement organization makes payment to the provider. However, relief from backup withholding for third party network transactions reportable under both section 6050W and section 6041 is not warranted because such transactions are not subject to reporting under section 6050W unless the *de minimis* thresholds are met. Thus, the payor with the obligation to report under section 6041 cannot determine with certainty whether a third party network transaction is required to be reported under section 6050W.

For payments that are subject to withholding under both sections 3402(t) and 6050W, the potential for duplicate withholding is complicated by the 3-percent withholding requirement contained within section 3402(t) itself. Section 3402(t) expressly provides exceptions to the 3-percent withholding requirement for payments that are subject to backup withholding under section 3406 if backup withholding is actually being deducted from the payment. Thus, where there is no 3-percent withholding on a government payment card transaction, the transaction will be subject to the higher 28-percent backup withholding under section 3406 instead of the 3-percent withholding under section 3402(t). However, a potential for duplicate backup withholding may arise if information reporting is required under both sections 3402(t) and 6050W but neither reporting requirement is satisfied.

The proposed regulations do not eliminate the requirement for backup withholding for transactions that are reportable under section 6050W and another Code section. Comments are requested on the circumstances under which relief for duplicate backup withholding is appropriate once backup withholding under section 6050W becomes effective.

Proposed Effective/Applicability Dates:

The amendments to the regulations as proposed will be effective on the date they are published as final regulations in the **Federal Register.**

With respect to the regulations under sections 6041, 6050W, 6051, 6721 and 6722, the regulations are proposed to apply to returns for calendar years beginning after December 31, 2010. With respect to the regulations under section 3406, the regulations are proposed to apply to amounts paid after December 31, 2011.

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. Pursuant to the Regulatory Flexibility Act (5.U.S.C. chapter 6), it is hereby certified that the regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the persons required to report under section 6050W, payment settlement entities, will generally not be small businesses. Merchant acquiring entities, the payment settlement entities required to report payment card transactions,

will primarily be banks with over $175 million in assets. Third party settlement organizations, the payment settlement entities required to report third party network transactions, will generally not be small entities by virtue of the definition of a third party payment network, which requires the establishment of accounts with a central organization (the third party settlement organization) by a substantial number of persons. Further, section 6050W(e) provides a *de minimis* exception that exempts third party settlement organizations from reporting transactions with respect to a payee if the aggregate amount of such transactions does not exceed $20,000 or the aggregate number of such transactions does not exceed 200. The IRS and the Treasury Department also request comments on the accuracy of the statement that the regulations in this document will not have a significant economic impact on a substantial number of small entities. Pursuant to section 7805(f) of the Code, this regulation has been 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 the Treasury Department request comments on the clarity of the proposed regulations and how they can be made easier to understand. Comments are requested on the examples in the proposed regulations, and commentators are specifically invited to suggest changes to these examples or to suggest new examples that they believe would better illustrate the principles that should be included in the final regulations. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 10, 2010 at 10 am in room 2615, 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 written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by January 27, 2010. 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 is Barbara Pettoni, Office of Associate Chief Counsel (Procedure and Administration).

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1, 31 and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6041–1 is amended by adding a sentence at the end of paragraph (a)(1)(ii) and adding paragraphs (a)(1)(iv) and (a)(1)(v) to read as follows:

§1.6041–1 Return of information as to payments of $600 or more.

(a) * * *(1) * * *(i) * * *

(ii) * * * For payment card transactions (as described in §1.6050W–1(b)) required to be reported on information returns required under section 6050W (relating to payment card and third party network transactions), see special rules in §1.6041–1(a)(1)(iv).

* * * * *

(iv) *Information returns required under section 6050W for calendar years beginning after December 31, 2010.* For payments made by payment card after December 31, 2010, that are required to be reported on an information return under section 6050W (relating to payment card and third party network transactions), the following rule applies. Payment card transactions that are described in paragraph (a)(1)(ii) of this section that otherwise would be reportable under both sections 6041 and 6050W are reported under section 6050W and not section 6041. For provisions relating to information reporting for payment card transactions, see §1.6050W–1.

(v) *Example*. The provisions of paragraph (a)(1)(iv) are illustrated by the following example:

Example. Restaurant owner A, in the course of business, pays $600 of fixed or determinable income to B, a repairman, by credit card. B is one of a network of unrelated persons that has agreed to accept A's credit card as payment under an agreement that provides standards and mechanisms for settling the transaction between a merchant acquiring bank and the persons who accept the cards. Merchant acquiring bank Y is responsible for making the payment to B. Under paragraph (a)(1)(iv) of this section, A, as payor, is not required to file an information return under section 6041 with respect to the transaction because Y, as the payment settlement entity for the payment card transaction, is required to file an information return under section 6050W.

* * * * *

Par. 3. Section §1.6050W–1 is added to read as follows:

§1.6050W–1 Information reporting for payments made in settlement of payment card and third party network transactions.

(a) *In general*—(1) *General rule.* Every payment settlement entity, as defined in paragraph (a)(3) of this section, must file an information return for each calendar year with respect to payments made in settlement of reportable payment transactions, as defined in paragraph (a)(2) of this section, setting forth the following information:

(i) The name, address, and taxpayer identification number (TIN) of each participating payee, as defined in paragraph (a)(4) of this section, to whom one or more payments in settlement of reportable payment transactions are made.

(ii) With respect to each participating payee, the gross amount, as defined in paragraph (a)(5) of this section, of—

(A) The aggregate reportable payment transactions for the calendar year; and

(B) The aggregate reportable payment transactions for each month of the calendar year.

(iii) Any other information required by the form, instructions or current revenue procedures.

(2) *Reportable payment transaction.* The term *reportable payment transaction* means any payment card transaction (as defined in paragraph (b)(1) of this section) and any third party network transaction (as defined in paragraph (c)(1) of this section).

(3) *Payment settlement entity*. The term *payment settlement entity* means a domestic or foreign entity that is—

(i) In the case of a payment card transaction, a merchant acquiring entity (as defined in paragraph (b)(2) of this section); and

(ii) In the case of a third party network transaction, a third party settlement organization (as defined in paragraph (c)(2) of this section).

(4) *Participating payee*—(i) *Definition*. In general, the term *participating payee* means any person, including any governmental unit (and any agency or instrumentality thereof), who:

(A) In the case of a payment card transaction, accepts a payment card (as defined in paragraph (b)(3) of this section) as payment; and

(B) In the case of a third party network transaction, accepts payment from a third party settlement organization (as defined in paragraph (c)(2) of this section) in settlement of such transaction.

(ii) *Foreign payees*. For special rules relating to foreign payees, see paragraph (d)(3) of this section.

(5) *Gross amount*. For purposes of this section, *gross amount* means the total dollar amount of aggregate reportable payment transactions for each participating payee without regard to any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts or any other amounts.

(b) *Payment card transactions*—(1) *Definition.* The term *payment card transaction* means any transaction in which a payment card, or any account number or other indicia associated with a payment card, is accepted as payment.

(2) *Merchant acquiring entity*. The term *merchant acquiring entity* means the bank or other organization that has the contractual obligation to make payment to participating payees (as defined in paragraph (a)(4)(i)(A) of this section) in settlement of payment card transactions.

(3) *Payment card*. (i) The term *payment card* means any card, including any stored-value card as defined in paragraph (b)(4) of this section, issued pursuant to an agreement or arrangement that provides for—

(A) One or more issuers of such cards;

(B) A network of persons unrelated to each other, and to the issuer, who agree to accept such cards as payment; and

(C) Standards and mechanisms for settling the transactions between the merchant acquiring entities and the persons who agree to accept the cards as payment.

(ii) Persons who agree to accept such cards as payment as described in this paragraph (b)(3) are participating payees within the meaning of paragraph (a)(4)(i)(A) of this section.

(4) *Stored-value cards*. The term *stored-value card* means any card with a prepaid value, including any gift card.

(c) *Third party network transactions*—(1) *Definition.* The term *third party network transaction* means any transaction that is settled through a third party payment network.

(2) *Third party settlement organization*. The term *third party settlement organization* means the central organization that has the contractual obligation to make payments to participating payees (as defined in paragraph (a)(4)(i)(B) of this section) of third party network transactions. A central organization is a third party settlement organization if it provides a third party payment network (as defined in paragraph (c)(3)(i) of this section) that enables purchasers to transfer funds to providers of goods and services.

(3) *Third party payment network*. (i) The term *third party payment network* means any agreement or arrangement that—

(A) Involves the establishment of accounts with a central organization by a substantial number of providers of goods or services who are unrelated to the organization and who have agreed to settle transactions for the provision of the goods or services to purchasers according to the terms of the agreement or arrangement;

(B) Provides standards and mechanisms for settling the transactions; and

(C) Guarantees payment to the persons providing goods or services in settlement of transactions with purchasers pursuant to the agreement or arrangement.

(ii) Persons who are providers of goods and services as described in this paragraph (c)(3) are participating payees within the meaning of paragraph (a)(4)(i)(B) of this section.

(4) *Exception for de minimis payments.* A third party settlement organization is required to report any information under paragraph (a)(1) of this section with respect to third party network transactions of any participating payee only if—

(i) The amount that would otherwise be reported under paragraph (a)(1)(ii) of this section with respect to such transactions exceeds $20,000; and

(ii) The aggregate number of such transactions exceeds 200.

(d) *Special rules*—(1) *Aggregated payees*. In any case where a person receives payments from a payment settlement entity (as defined in paragraph (a)(3) of this section) on behalf of one or more participating payees and distributes such payments to one or more participating payees (as defined in paragraph (a)(4) of this section), the person is treated as:

(i) The participating payee with respect to the payment settlement entity; and

(ii) The payment settlement entity with respect to the participating payees to whom the person distributes payments.

(2) *Electronic payment facilitator*. If a payment settlement entity (as defined in paragraph (a)(3) of this section) contracts with an electronic payment facilitator or other third party to settle reportable payment transactions on behalf of the payment settlement entity, the electronic payment facilitator or other third party must file the annual information return under this section in lieu of the payment settlement entity. The electronic payment facilitator or other third party who makes payment on behalf of the payment settlement entity is the party that will be liable for any applicable penalties for failure to comply with the information reporting requirements of section 6050W.

(3) *Foreign payees*—(i) *In general*. A payment settlement entity that is a person described as a U.S. payor or U.S. middleman in §1.6049–5(c)(5) is not required to make a return of information for payments to a participating payee with a foreign address as long as, prior to payment, the payee has provided the payment settlement entity with documentation upon which the payment settlement entity may rely to treat the payment as made to a foreign person in accordance with §1.1441–1(e)(1)(ii). For purposes of this paragraph (d)(3)(i), the provisions of §1.1441–1 shall apply by substituting the term payor for the term withholding agent and without regard to the limitation to amounts subject to withholding under chapter 3 of the Internal Revenue Code and the regulations under that chapter.

(ii) *Special rule*. A payment settlement entity that is not a person described as a U.S. payor or U.S middleman in §1.6049–5(c)(5) is not required to make a return of information for a payment to a participating payee that does not have a United States address as long as the payment settlement entity neither knows nor has reason to know that the participating payee is a United States person.

(iii) *Foreign address; United States address*. For purposes of this section, *foreign address* means any address that is not within the United States, as defined in section 7701(a)(9) of the Internal Revenue Code (the States and the District of Columbia). *United States address* means any address that is within the United States.

(4) *Unrelated persons*. For purposes of this section, *unrelated* means any person who is not related to another person within the meaning of section 267(b) (providing a list of relationships), including the application of section 267(c) and (e)(3) (providing rules relating to constructive ownership), and section 707(b)(1) (relationships with partnerships).

(e) *Examples*. The following examples illustrate the provisions of this section:

Example 1. Merchant acquiring entity. Customer A purchases goods from merchant B using a credit card issued by Bank X. B is one of a network of unrelated persons that has agreed to accept credit cards issued by X as payment under an agreement that provides standards and mechanisms for settling the transaction between a merchant acquiring bank and the persons who accept the cards. Bank Z is the bank with the contractual obligation to make payment to B for goods provided to A in the above transaction. As defined in paragraph (b)(2) of this section, Z is the merchant acquiring entity that must file the annual information return required under paragraph (a)(1) of this section to report the payment made to settle the transaction for the sale of goods from B to A.

Example 2. Third party settlement organization. (i) Merchant B is one of a substantial number of persons selling goods or services over the Internet that have an account with X, an Internet payment service provider. None of these persons, including B, are related to X, and all have agreed to settle transactions for the sale of goods or services to customers according to the terms of their contracts with X. X has guaranteed payment to all of these persons, including B, for the sale of goods or services to customers. Customer A purchases goods from B. A pays X for the goods purchased from B. X, in turn, makes payment to B in settlement of the transaction for the sale of goods from B to A.

(ii) X's arrangement constitutes a third party payment network as defined in paragraph (c)(3) of this section because a substantial number of persons that are unrelated to X, including B, have established accounts with X, and X is contractually obligated to settle transactions for the provision of goods or services by these persons to purchasers. Thus, under paragraph (c)(2) of this section, X is a third party settlement organization and the transaction discussed in this example is a third party network transaction under paragraph (c)(1) of this section. Therefore, X must file the annual information return required under paragraph (a)(1) of this section to report the payment made to B in settlement of the transaction with A provided that X's aggregate payments to B from third party network transactions exceed $20,000 and the aggregate number of X's transactions with B exceeds 200 (as provided in paragraph (c)(4) of this section).

Example 3. Automated clearing house network. A operates an automated clearing house ("ACH") network that merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers. There are no contractual agreements between A and the sellers for the purpose of permitting the sellers to use the ACH network. Thus, A is not a third party settlement organization under paragraph (c)(2) of this section, the ACH network is not a third party payment network under paragraph (c)(3) of this section, and the electronic payment transactions are not third party network transactions under paragraph (c)(1) of this section. A is not required to file the annual information return required under paragraph (a)(1) of this section.

Example 4. Gross amount. Customer A uses a payment card to purchase $100 worth of goods at merchant B. Bank X, the merchant acquiring entity for B, is the party with the contractual obligation to make payment to B in settlement of the transaction. X, after deducting fees of $2, makes payment of $98 to settle the transaction for the sale of goods from B to A. Under paragraph (a)(5) of this section, X must report the amount of $100, without any reduction for fees or any other amount, as the gross amount of this reportable payment transaction on the annual information return filed under paragraph (a)(1) of this section.

Example 5. Gift card. (i) Customer A purchases a gift card from Merchant X that may be used only at X and its related network of stores. A purchases the gift card using cash. A gives the gift card to B. B uses the gift card to purchase goods at one of X's stores. The purchase of the gift card by A using cash is not a payment card transaction described in paragraph (b)(1) of this section and, thus,is not required to be reported in a return of information required under paragraph (a)(1) of this section. Under paragraph (b)(3) of this section, the gift card is not a payment card because the gift card is accepted as payment by a person who is related to the issuer of the gift card. Therefore, the use of the gift card by B is not required to be reported in a return of information required under paragraph (a)(1) of this section.

(ii) The facts are the same as in paragraph (i), except that B adds value to the gift card using a credit card. The use of the credit card to add value to the gift card is a reportable payment transaction (as defined in paragraph (a)(2) of this section) and must be reported in a return of information under this section by the bank or other organization that has the contractual obligation to make payment to X in settlement of the transaction.

Example 6. Campus card. (i) Student A purchases a card issued by University Y that may be used on campus at various university-owned merchants and at various local merchants unrelated to Y. A uses the card in the university-owned cafeteria to purchase lunch. Under paragraph (b)(3) of this section, the campus card is not a payment card in this transaction because the card is accepted as payment by a person who is related to the issuer of the card. Therefore, the use of the campus-card by A in the university cafeteria is not required to be reported in a return of information required under paragraph (a)(1) of this section.

(ii) The facts are the same as in paragraph (i), except that A uses the campus card to purchase lunch at a local restaurant, unrelated to Y, that has agreed to accept the campus card as payment. Under paragraph (b)(3) of this section, the campus card is a payment card in this transaction because the card is accepted as payment by a person that is unrelated to this issuer of the card pursuant to an agreement. Therefore, the use of the card by A in the local restaurant for the purchase of lunch must be reported in a return of information required under paragraph (a)(1) of this section by the bank or other organization that has the contractual obligation to make payment to the restaurant in settlement of the transaction.

Example 7. Prepaid telephone card. A purchases a prepaid telephone card from Company X that may be used to make telephone calls using various long-distance providers unrelated to X that have agreed to accept the card as payment. A places a telephone call using the prepaid card as payment for the telephone call. Under paragraph (b)(3) of this section, the prepaid telephone card is a payment card because the card is accepted as payment by a person that is unrelated to the issuer of the card pursuant to an agreement. Therefore, the use of the prepaid card to make payment for the telephone call must be reported in a return of information required under paragraph (a)(1) of this section by the bank or other organization that has the contractual obligation to make payment to the long distance provider in settlement of the transaction.

Example 8. Transit card. City Z accepts a transit card as payment for use of its mass transit system.

The transit card is issued by B, an organization unrelated to Z. A network of persons, including Z, who are unrelated to each other and to B, have agreed to accept the transit card issued by B as payment for transit and for other goods and services. Transit rider X purchases a transit card and uses the card to pay for travel on Z's mass transit system. Under paragraph (b)(3) of this section, the transit card is a payment card because the card is accepted as payment by a person who is one of a network of persons that are unrelated to the issuer of the card and that have agreed to accept the card as payment. Therefore, the use of the transit card by X to pay for transit on Z's mass transit system is a payment card transaction described in paragraph (b)(1) of this section that must be reported in a return of information required under paragraph (a)(1) of this section by the bank or other organization that has the contractual obligation to make payment to Z. Z is the participating payee, described in paragraph (a)(4)(i)(A) of this section, of the payment card transaction.

Example 9. Healthcare network. Health carrier A operates healthcare network Y. A collects premiums from covered persons pursuant to a plan agreement between A and the covered persons for the cost of membership in Y. Separately, A pays healthcare providers pursuant to provider agreements to compensate these providers for services rendered to covered persons who are members of Y. A is not a third party settlement organization under paragraph (c)(2) of this section because A does not operate a third party payment network that enables purchasers to transfer funds to providers of goods and services. Therefore, A is not required to file the annual information return required under paragraph (a)(1) of this section.

Example 10. Third party accounts payable. X is a "shared-service" organization that performs accounts payable services for numerous purchasers that are unrelated to X. A substantial number of providers of goods and services have established accounts with X and have agreed to accept payment from X in settlement of their transactions with purchasers. The provider agreement with X includes standards and mechanisms for settling the transactions and guarantees payment to the providers, and the arrangement enables purchasers to transfer funds to providers. Under paragraph (c)(3) of this section, X's accounts payable services constitute a third party payment network, of which X is the third party settlement organization (as defined in paragraph (c)(2) of this section). For each payee, X must file the annual information return required under paragraph (a)(1) of this section to report payments made by X in settlement of accounts payable to that payee if X's aggregate payments to that payee exceed $20,000 and the aggregate number of transactions with that payee exceeds 200 (as provided in paragraph (c)(4) of this section).

Example 11. Toll collection network. State A charges a toll to vehicles that travel its state highways. The tolling agency for A contracted with organization X to perform its toll collection. X provides an electronic toll collection system that allows the toll facility to record the passage of a vehicle with a transponder affixed to the vehicle. The customer account associated with the transponder is automatically debited for the amount of the toll. The customer funds a balance in the account, which is then depleted as the toll transactions occur. X periodically bills the customer to replenish the account. X then makes payment to A to settle the toll transactions that are recorded by the transponder. X also contracts with a substantial number of other entities unrelated to X that have established accounts with X and have agreed to accept payment using the electronic toll collection system provided by X. X guarantees payment to the entities for all toll transactions that are recorded by the transponders, and the arrangement enables customers to transfer funds to State A and other entities that charge tolls. Under paragraph (c)(3) of this section, X's electronic toll collection system constitutes a third party payment network, of which X is the third party settlement organization (as defined in paragraph (c)(2) of this section). For each payee, including A, X must file the annual information return required under paragraph (a)(1) of this section to report payments made by X in settlement of toll transactions if X's aggregate payments to that payee exceed $20,000 and the aggregate number of transactions with that payee exceeds 200 (as provided in paragraph (c)(4) of this section).

Example 12. Hotel kiosk. Under a "hotel kiosk" arrangement, Hotel B permits its customers to charge, to their room account, transactions for goods and services at a substantial number of sellers unrelated to B that operate on B's premises and have established accounts in B's hotel kiosk system. Customers settle their room account with B when they check out, and B in turn settles the hotel kiosk transactions with the unrelated sellers. B guarantees payment to the sellers for these transactions and the arrangement enables customers to transfer funds to the sellers by means of one payment made to the hotel. Under paragraph (c)(3) of this section, B's hotel kiosk system constitutes a third party payment network, of which B is the third party settlement organization (as defined in paragraph (c)(2) of this section). For each payee, B must file the annual information return required under paragraph (a)(1) of this section to report payments made by B in settlement of the hotel kiosk transactions if B's aggregate payments to that payee exceed $20,000 and the aggregate number of transactions with that payee exceeds 200 (as provided in paragraph (c)(4) of this section).

Example 13. Aggregated payee. Corporation A, acting on behalf of A's independently-owned franchise stores, receives payment from Bank X for credit card sales effectuated at these franchise stores. X, the payment settlement entity (as defined in paragraph (a)(3)(i) of this section), is required under paragraph (d)(1)(i) of this section to report the gross amount of the reportable payment transactions distributed to A (notwithstanding the fact that A does not accept payment cards and would not otherwise be treated as a participating payee). In turn, under paragraph (d)(1)(ii), A is required to report the gross amount of the reportable payment transactions allocable to each franchise store. X has no reporting obligation under this section with respect to payments made by A to its franchise stores.

Example 14. Electronic payment facilitator. Bank A is a merchant acquiring entity (as defined in paragraph (b)(2) of this section) with the contractual obligation to make payments to participating merchants to settle certain credit card transactions. X enters into a contract with A to settle these credit card transactions electronically on behalf of A. Under paragraph (d)(2) of this section, X is an electronic payment facilitator and must file the information return required under paragraph (a)(1) of this section with respect to A's credit card transactions settled by X. A has no reporting obligation with respect to payments made by X on A's behalf.

(f) *Prescribed form.* The return required by paragraph (a)(1) of this section must be made according to the forms and instructions published by the IRS.

(g) *Time and place for filing.* Returns made under this section for any calendar year must be filed on or before February 28th (March 31st if filing electronically) of the following year at the Internal Revenue Service Center location designated in the instructions to the relevant form.

(h) *Time and place for furnishing statement*—(1) *In general.* Every payment settlement entity required to file a return under this section must also furnish to each participating payee a written statement with the same information (as described in paragraph (h)(2) of this section). The statement must be furnished to the payee on or before January 31st of the year following the calendar year in which the reportable payment is made. If the return of information is not made on magnetic media, this requirement may be satisfied by furnishing to such person a copy of all Forms 1099–K, "*Merchant Card and Third-Party Payments*," or any successor form with respect to such person filed with the Internal Revenue Service Center. The statement will be considered furnished to the payee if it is mailed to the payee's last known address. The payment settlement entity may furnish the statement electronically with the prior consent of the payee.

(2) *Information to be shown on statement furnished to payee.* Each written statement furnished under paragraph (h)(1) of this section must include the following information—

(i) The name, address, and phone number (or email address if the statement is furnished electronically) of the information contact of the payment settlement entity.

(ii) With respect to the participating payee, the gross amount of—

(A) The aggregate reportable payment transactions for the calendar year; and

(B) The aggregate reportable payment transactions for each month of the calendar year.

(iii) Any other information required by the form, instructions, or current revenue procedures.

(i) *Cross-reference to penalties*. For provisions relating to the penalty for failure to file timely a correct information return required under section 6050W, see §301.6721–1 of this chapter (Procedure and Administration Regulations). For provisions relating to the penalty for failure to furnish timely a correct payee statement required under section 6050W(f), see §301.6722–1 of this chapter. See §301.6724–1 of this chapter for the waiver of a penalty if failure is due to reasonable cause and is not due to willful neglect.

(j) *Effective/applicability date*. The rules in this section apply to returns for calendar years beginning after December 31, 2010. The rules in this section are effective on the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 4. The authority citation for part 31 continues to read in part as follows:

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

Par. 5. Section 31.3406–0 is amended as follows:

1. Entries for §31.3406(b)(3)–5(a), (b) and (c) are added.

2. Entry for §31.3406(g)–1 is amended by adding paragraphs (d), (e), and (f).

The additions read as follows:

§31.3406–0 Outline of the backup withholding regulations.

* * * * *

§31.3406(b)(3)–5 Reportable payments of payment card and third party network transactions.

(a) Payment card and third party network transactions subject to backup withholding.

(b) Amount subject to backup withholding.

(c) Effective/applicability date.

* * * * *

§31.3406(g)–1 Exception for payments to certain payees and certain other payments.

* * * * *

(d) Reportable payments made to Canadian nonresident alien individuals.

(e) Certain reportable payments made outside the United States by foreign persons, foreign offices of United States banks and brokers, and others.

(f) Special rule for certain payment card transactions.

* * * * *

Par. 6. Section 31.3406(a)–2 is amended by revising paragraph (a) to read as follows:

§31.3406(a)–2 Definition of payors obligated to backup withhold.

(a) *In general*. *Payor* means the person that is required to make an information return under sections 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, 6050N, or 6050W with respect to any reportable payment (as described in section 3406(b)), or that is described in paragraph (b) of this section.

* * * * *

Par. 7. Section 31.3406(b)(3)–5 is added to read as follows:

§31.3406(b)(3)–5 Reportable payments of payment card and third party network transactions.

(a) *Payment card and third party network transactions subject to backup withholding*. A payment of a kind, and to a payee, that is required to be reported under section 6050W (relating to information reporting for payment card and third party network transactions) is a reportable payment for purposes of section 3406. See §31.6051–4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding*. In general, the amount described in paragraph (a) of this section that is subject to withholding under section 3406 is the amount subject to reporting under section 6050W.

(c) *Effective/applicability date*. The provisions of this section apply to amounts paid after December 31, 2011.

Par. 8. Section 31.3406(d)–1 is amended by revising paragraph (d) to read as follows:

§31.3406(d)–1 Manner required for furnishing a taxpayer identification number.

* * * * *

(d) *Rents, commissions, nonemployee compensation, certain fishing boat operators, and payment card and third party network transactions, etc.—Manner required for furnishing a taxpayer identification number*. For accounts, contracts, or relationships subject to information reporting under section 6041 (relating to information reporting at source on rents, royalties, salaries, etc.), section 6041A(a) (relating to information reporting of payments for nonemployee services), section 6050A (relating to information reporting by certain fishing boat operators), section 6050N (relating to information reporting of payments of royalties), or section 6050W (relating to information reporting for payment card and third party network transactions), the payee must furnish the payee's taxpayer identification number to the payor either orally or in writing. Except as provided in §31.3406(d)–5, the payee is not required to certify under penalties of perjury that the taxpayer identification number is correct regardless of when the account, contract, or relationship is established.

Par. 9. Section 31.6051–4 is amended by revising paragraph (c)(2) to read as follows:

§31.6051–4 Statement required in case of backup withholding.

* * * * *

(c)* * *

(2) The amount subject to reporting under sections 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, 6050N, or 6050W whether or not the amount of the reportable payment is less than the amount for which an information return is required. If tax is withheld under section 3406, the statement must show the amount of the payment withheld upon;

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 10. Section 301.6721–1(g) is amended by:

1. Removing the language "or" at the end of paragraphs (g)(2)(vi) and (g)(3)(xii).

2. Redesignating paragraph (g)(2)(vii) as (g)(2)(viii).

3. Adding new paragraph (g)(2)(vii).

4. Redesignating paragraphs (g)(3)(viii), (g)(3)(ix), (g)(3)(x), (g)(3)(xi), (g)(3)(xii) and (g)(3)(xiii) as (g)(3)(ix), (g)(3)(x), (g)(3)(xi), (g)(3)(xii), (g)(3)(xiii) and (g)(3)(xiv).

5. Adding the language "or" at the end of newly designated paragraph (g)(3)(xiii).

6. Adding new paragraph (g)(3)(viii).

The revisions and additions read as follows:

§301.6721–1 Failure to file correct information returns.

* * * * *

(g)* * * (2)* * *

(vii) Section 6050W (relating to information returns with respect to payments made in settlement of payment card and third party network transactions (effective for information returns required to be filed for calendar years beginning after December 31, 2010)), or

* * * * *

(3)* * *

(viii) Section 6050W (relating to information returns with respect to payments made in settlement of payment card and third party network transactions (effective for information returns required to be filed for calendar years beginning after December 31, 2010)),

* * * * *

Par. 11. Section 301.6722–1 is amended by:

1. Removing the language "and" at the end of paragraph (d)(2)(xviii).

2. Redesignating paragraphs (d)(2)(xvi), (d)(2)(xvii), (d)(2)(xviii) and (d)(2)(xix) as (d)(2)(xvii), (d)(2)(xviii), (d)(2)(xix) and (d)(2)(xx).

3. Adding new paragraph (d)(2)(xvi).

4. Adding the language "and" at the end of the newly designated paragraph (d)(2)(xix).

5. Adding new paragraph (f).

The revisions and additions read as follows:

§301.6722–1 Failure to furnish correct payee statements.

* * * * *

(d)* * * (2)* * *

(xvi) Section 6050W (relating to information returns with respect to payments made in settlement of payment card and third party network transactions, generally the recipient copy),

* * * * *

(f) *Effective/Applicability date.* The provisions of paragraph (d)(2)(xvi) of this section apply to information returns required to be filed for calendar years beginning after December 31, 2010.

* * * * *

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

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2009–86

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on December 7, 2009, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Gehrig and Margaret White Charitable Foundation
Charlotte, NC

Downs Family Foundation
Detroit, MI

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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