Internal Revenue
bulletin

Bulletin No. 2012-2
January 9, 2012

HIGHLIGHTS OF THIS ISSUE

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

SPECIAL ANNOUNCEMENT

T.D. 9559, page 252.

Final regulations amend the user fee regulations and establish a new user fee for individuals to take the registered tax return preparer competency examination.

INCOME TAX

Rev. Rul. 2012–1, page 255.

Recurring item exception to the all events test. This ruling clarifies the treatment of certain liabilities under the recurring item exception to the economic performance requirement under section 461(h)(3) of the Code. It also addresses the application of the "not material" and "better matching" requirement of the recurring item exception in the context of a lease and a service contract each having a term of one year. The ruling distinguishes contracts for the provision of services from insurance and warranty contracts and applies the recurring item exception differently. Rev. Proc. 2011–14 modified and amplified.

T.D. 9559, page 252.

Final regulations amend the user fee regulations and establish a new user fee for individuals to take the registered tax return preparer competency examination.

REG–149625–10, page 279.

Proposed regulations under section 382 of the Code provide exceptions to the segregation rules, under which certain transactions may create one or more additional public groups treated as 5-percent shareholders, for certain sales of loss corporation stock to small shareholders and for certain redemptions of small shareholders. The regulations also provide that in certain circumstances certain entities owning the loss corporation generally will be treated as having no more than one public group.

EXEMPT ORGANIZATIONS

Rev. Proc. 2012–9, page 261.

This procedure sets forth issuing determination letters and rulings on the exempt status of organizations under sections 501 and 521 of the Code. The procedures also apply to the revocation and modification of determination letters or rulings, and provide guidance on the exhaustion of administrative remedies for purposes of declaratory judgment under section 7428 of the Code. Rev. Proc. 2011–9 superseded.

Rev. Proc. 2012–10, page 273.

This procedure sets forth updated procedures with respect to issuing rulings and determination letters on private foundation status under § 509(a) of the Code, operating foundation status under § 4942(j)(3), and exempt operating foundation status under § 4940(d)(2), of organizations exempt from Federal income tax under § 501(c)(3). This procedure also applies to the issuance of determination letters on the foundation status under § 509(a)(3) of nonexempt charitable trusts described in § 4947(a)(1). Rev. Proc. 2011–10 superseded.

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Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

T.D. 9559, page 252.
Final regulations amend the user fee regulations and establish a new user fee for individuals to take the registered tax return preparer competency examination.

Notice 2012–1, page 260.
Optional standard mileage rates for 2012. This notice announces 55.5 cents as the optional standard mileage rate for substantiating the amount of the deduction for the business use of an automobile, 14 cents as the optional rate for use of an automobile as a charitable contribution, and 23 cents as the optional rate for use of an automobile as a medical or moving expense for 2012. The notice also provides the amount a taxpayer must use in calculating reductions to basis for depreciation taken under the business standard mileage rate and the maximum standard automobile cost for automobiles under a FAVR allowance. Notice 2010–88, as modified by Announcement 2011–40, is superseded.

Rev. Proc. 2012–12, page 275.
This procedure describes the procedures and standards that organizations must follow to be identified by the Service as a qualifying organization that may accredit continuing education providers under section 10.9(a)(1)(iii) of Circular 230 and the procedures and standards that individuals and entities must follow to be approved as continuing education providers under section 10.9(a)(1) of Circular 230.

Announcement 2012–2, page 285.
This announcement contains an update to Publication 1220, *Specifications for Filing Forms 1097, 1098, 1099, 3921, 3922, 5498, 8935 and W–2G, Electronically,* revised 9–2011, concerning the filing of Form 1099–K.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the 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

26 CFR 300.0: User fees; in general.

T.D. 9559

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 300

User Fee to Take the Registered Tax Return Preparer Competency Examination

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains amendments to the user fee regulations. The final regulations redesignate rules pertaining to fee for obtaining a preparer tax identification number. These final regulations also establish a user fee for individuals to take the registered tax return preparer competency examination. The final regulations affect individuals who take the registered tax return preparer competency examination. The charging of user fees is authorized by the Independent Offices Appropriations Act of 1952.

DATES: *Effective Date:* These regulations are effective beginning November 25, 2011.

Applicability Date: For date of applicability, see §300.12(d).

FOR FURTHER INFORMATION CONTACT: Concerning the final regulations, Emily M. Lesniak at (202) 622–4570; concerning cost methodology Eva J. Williams at (202) 435–5514 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations establishing a user fee to take the registered tax return preparer competency examination. New §300.12 establishes a $27 IRS user fee to take the registered tax return preparer competency examination; this IRS user fee is in addition to any reasonable, IRS-approved fee charged by the third-party vendor. These regulations also redesignate prior §300.12 as §300.13.

The Independent Offices Appropriations Act of 1952 (IOAA), which is codified at 31 U.S.C. 9701, authorizes agencies to prescribe regulations establishing user fees for services provided by the agency. Regulations prescribing user fees are subject to the policies of the President, which are currently set forth in the Office of Management and Budget Circular A–25 (the OMB Circular), 58 FR 38142 (July 15, 1993). The OMB Circular requires agencies seeking to impose user fees for providing special benefits to identifiable recipients to calculate the full cost of providing those benefits.

These regulations are part of a broader IRS effort to increase the oversight of the tax return preparer community. As part of this effort, Treasury and the IRS published final regulations in the **Federal Register** (T.D. 9527, 2011–27 I.R.B. 1 [76 FR 32286]) on June 3, 2011, amending the regulations governing practice before the IRS. These regulations are found in 31 CFR part 10 and have been reprinted as Treasury Department Circular No. 230 (Circular 230). The amendments to Circular 230, in part, include registered tax return preparers as practitioners under Circular 230. Registered tax return preparers must demonstrate the necessary qualifications and competency, which includes passing a minimum competency examination. Registered tax return preparers receive the special benefit of being able to prepare and sign tax returns, claims for refund, and other documents as provided in forms, instructions, or other appropriate guidance.

On September 26, 2011, Treasury and the IRS published a notice of proposed rulemaking (REG–116284–11, 2011–43 I.R.B. 598) in the **Federal Register** (76 FR 59239) proposing a user fee to take the registered tax return preparer competency examination. The notice of proposed rulemaking also proposed to establish a user fee to be fingerprinted in conjunction with the preparer tax identification number, acceptance agent, and authorized e-file provider programs. These regulations only finalize the user fee to take the registered tax return preparer competency examination.

The notice of proposed rulemaking announced a public hearing on October 7, 2011. Four individuals testified at the public hearing. The testimony at the hearing focused on the proposed fingerprinting user fee. No individual at the hearing offered testimony on the competency examination user fee.

Treasury and the IRS received written comments responding to the notice of proposed rulemaking. These comments are available for public inspection at *http://www.regulations.gov* or upon request. After consideration of all the comments, the proposed regulations are adopted as modified by this Treasury decision.

Summary of Comments and Explanation of Revisions

Treasury and the IRS received more than twenty written comments in response to the notice of proposed rulemaking. Treasury and the IRS received four written comments relating to the user fee to take the registered tax return preparer competency examination. The majority of the written comments concerned the user fee to be fingerprinted in conjunction with the preparer tax identification number, acceptance agent, and authorized e-file provider programs. Treasury and the IRS also received a few comments regarding other aspects of the IRS's efforts to regulate tax return preparers. To the extent that comments address other aspects of the IRS's increased oversight of the tax return preparation industry, the comments will be addressed, as appropriate and practicable, in future guidance. Further, some of the comments received related to testing locations and whether an online examination would be offered. The IRS received similar comments in response to Notice 2011–48, 2011–26 I.R.B. 927 (June 27, 2011) available at *www.irs.gov/pub/irs-irbs/irb11–26.pdf*, which specifically requested comments regarding the registered tax return preparer

competency examination. The IRS and the competency examination vendor continue to consider these comments, along with other comments received in response to Notice 2011–48, as they implement the competency testing program. The IRS is committed to addressing the concerns expressed in these comments to the extent practical and appropriate.

One comment regarding the proposed user fee to take the registered tax return preparer competency examination encouraged Treasury and the IRS to monitor the fee charged by the third-party vendor. The third-party vendor's fee is approved by the IRS, including any changes to the vendor's fee. Thus, the IRS will be aware of any possible fee changes and will approve the final vendor fee.

Three comments related to the total cost and the components of the user fee to take the registered tax return preparer competency examination. These comments expressed a general concern that the fee may be a financial burden on tax return preparation businesses. One commentator requested that a definitive, specific fee amount be provided and expressed confusion over whether a single user fee covers multiple attempts to take the examination. Another commentator stated that the fee was duplicative for preparers who are independently tested under an employer's program, and requested that the IRS develop a process to review and certify employer testing programs.

Treasury and the IRS have considered these comments, and for the reasons described in this preamble, the portion of the proposed regulations relating to the user fee for the competency examination is finalized without substantive change.

As stated earlier in this preamble, the OMB Circular generally requires agencies to recover the full cost of providing a special benefit to an identifiable recipient. The full cost to the IRS to administer the registered tax return preparer competency examination is $27 per applicant each time the applicant takes the examination. The costs to the IRS to administer the competency examination include conducting background checks on employees of the third-party vendor who are involved in the administration of the examination and the personnel, administrative, management, and information technology costs to the IRS for developing and reviewing the competency examination, overseeing the competency examination, validating the competency examination results, and establishing a review procedure for applicants who contest any portion of the competency examination. The IRS will make expenditures for all of these costs associated with the competency examination and, thus, is generally required to recover these costs through a user fee as provided by the OMB Circular. The IRS will inform the public of the total finalized testing fee amount before the test becomes available. Because each examination-sitting will involve the same costs, a user fee will be charged each time an applicant takes the examination.

Further, these regulations are part of Treasury's and the IRS's effort to increase oversight of the tax return preparer industry based upon findings and recommendations made by the IRS in Publication 4832, *"Return Preparer Review"* (the Report), which was published on January 4, 2010. All individuals who wish to become a registered tax return preparer must pass the competency examination because, during the implementation process, Treasury and the IRS concluded that all registered tax return preparers should be subject to uniform standards of qualification and practice, which includes demonstrating a minimum level of competency. When obtaining tax return preparation services, taxpayers should know that all registered tax return preparers are subject to the same federal regulations and standards, regardless of where the registered tax return preparer is employed or in what state the individual resides. Requiring all registered tax return preparers to fulfill the same competency examination requirements ensures that all registered tax return preparers have met the same minimum competency standards. Additionally, requiring all registered tax return preparers to pass the IRS approved competency examination addresses concerns raised by several commentators during the IRS's study of the tax return preparation industry about the potential for unfairness if certain tax return preparers are exempt from these requirements. Accordingly, Treasury and the IRS do not believe that a process to review and certify employer testing is appropriate.

The comments on the user fee to be fingerprinted in conjunction with the preparer tax identification number, acceptance agent, and authorized e-file provider programs by and large expressed concern with the IRS's plan to fingerprint participants in these programs generally, as well as the imposition and amount of the proposed user fee. In light of the significant issues raised at the hearing and in the written comments received on the fingerprinting user fee, Treasury and the IRS have decided not to finalize the proposed user fee to be fingerprinted in conjunction with the preparer tax identification number, acceptance agent, and authorized e-file provider programs at this time. Rather, Treasury and the IRS will consider alternatives as to how the IRS can best implement the Circular 230 provision authorizing the IRS to conduct a suitability check to become a registered tax return preparer. In evaluating these alternatives, consideration will be given to how the suitability check achieves the goals of increasing oversight of the tax return preparer community and how the suitability check can be conducted most efficiently while not creating undue burden on the individual applicants and the firms or other entities that employ them. Thus, Treasury and the IRS are still interested in receiving further comments regarding the use of fingerprinting as part of the suitability check to become a registered tax return preparer. If the result of this reconsideration will require any individual to pay a user fee in conjunction with the implementation of the suitability check, including a possible fingerprinting requirement, Treasury and the IRS will publish a new notice of proposed rulemaking with respect to this user fee.

Treasury and the IRS adopt the proposed regulations after eliminating the proposed user fee to be fingerprinted in conjunction with the preparer tax identification number, acceptance agent, and authorized e-file provider programs. The portion of the proposed regulations pertaining to the user fee to take the registered tax return preparer competency examination is adopted without substantive modification.

Effective/Applicability Date

The Administrative Procedure Act provides that substantive rules will not be effective until thirty days after the final regulations are published in the **Federal Register** (5 U.S.C. 553(d)). Final regulations

may be effective prior to thirty days after publication if the publishing agency finds that there is good cause for an earlier effective date.

This regulation is part of the IRS's continued efforts to implement the recommendations in the Report. The recently published amendments to Circular 230 established registered tax return preparers as practitioners under Circular 230 and required that individuals must pass a competency examination, among other requirements, to become a registered tax return preparer. Before the competency examination can be offered, the competency examination user fee must be in place. Further, to enable the IRS to begin designating individuals as registered tax return preparers in time for the 2012 filing season, the competency examination user fee must be finalized significantly before the 2012 filing season.

Thus, the Treasury and the IRS find that there is good cause for these regulations to be effective upon the publication of these final regulations in the **Federal Register**.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563.

It has been determined that a final regulatory flexibility analysis under 5 U.S.C. 603 is required for this final rule. The analysis is set forth under the heading, "Final Regulatory Flexibility Analysis."

Pursuant to 26 U.S.C. 7805(f), the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. The Chief Counsel for Advocacy did not submit comments on the notice of proposed rulemaking.

FINAL REGULATORY FLEXIBILITY ANALYSIS

When an agency either promulgates a final rule that follows a required notice of proposed rulemaking or promulgates a final interpretative rule involving the internal revenue laws that imposes a collection of information requirement on small entities as described in 5 U.S.C. 603(a), the Regulatory Flexibility Act (5 U.S.C. chapter 6) requires the agency to "prepare a final regulatory flexibility analysis." A final regulatory flexibility analysis must, pursuant to 5 U.S.C. 604(a), contain the five elements listed in this final regulatory flexibility analysis. For purposes of this final regulatory flexibility analysis, a small entity is defined as a small business, small nonprofit organization, or small governmental jurisdiction. See 5 U.S.C. 601(3)-(6). The Treasury and the IRS conclude that the final regulations (together with other contemplated guidance provided for in these regulations) will impact a substantial number of small entities and the economic impact may be significant.

A statement of the need for, and the objectives of, the final rule.

The Treasury and the IRS are implementing regulatory changes that increase the oversight of the tax return preparer industry based upon findings and recommendations in the Report. These regulatory changes include establishing registered tax return preparers as Circular 230 practitioners. Individuals who wish to become a registered tax return preparer must pass a competency examination. Individuals who pass the competency examination and become a registered tax return preparer will receive a special benefit that the general public does not receive because a registered tax return preparer is allowed to prepare and sign Form 1040 series returns (and accompanying schedules) for compensation. The regulations under section 6109 (75 FR 60309) in conjunction with Notice 2011–6, 2011–3 I.R.B. 315 (January 17, 2011), provide that only attorneys, certified public accountants, enrolled agents, and registered tax return preparers can prepare and sign all or substantially all of a Form 1040 series return (and accompanying schedules) for compensation. This final rule recovers the full costs to the IRS to oversee the registered tax return preparer competency examination.

Summaries of the significant issues raised in the public comments responding to the initial regulatory flexibility analysis and of the agency's assessment of the issues, and a statement of any changes made to the rule as a result of the comments.

Treasury and the IRS received no public comments responding to the initial regulatory flexibility analysis related to competency testing in the proposed regulations that preceded these final regulations. Treasury and the IRS did receive comments from the public on the proposed regulations in general. A summary of these comments along with Treasury's and the IRS's assessment of the issues raised in the comments and descriptions of any revisions resulting from the comments is set forth elsewhere in this preamble under the Summary of Comments and Explanation of Revisions heading.

A description and an estimate of the number of small entities to which the rule will apply or an explanation of why an estimate is not available.

These final regulations affect all individuals who want to become a registered tax return preparer under the new oversight rules in Circular 230. Only individuals, not businesses, can practice before the IRS or become a registered tax return preparer. Thus, the economic impact of these regulations on any small entity generally will be a result of applicants owning a small business or a small entity employing applicants. The NAICS code that relates to tax preparation services (NAICS code 541213) is the appropriate code for the registered tax return preparer program. Entities identified as tax preparation services are considered small under the Small Business Administration size standards (13 CFR 121.201) if their annual revenue is less than $7 million. The IRS estimates that approximately 350,000 individuals will become registered tax return preparers. The IRS estimates that approximately 70 to 80 percent of the individuals who apply to become registered tax return preparers are operating as or employed by small entities.

A description of the projected reporting, recordkeeping, and other compliance requirements of the rule, including an estimate of the classes of small entities subject to the requirements and the type of professional skills necessary for preparation of a report or record.

The final regulations do not directly impose any reporting or recordkeeping requirements on any small entities. The final regulations, however, require certain tax return preparers to pay a user fee to take the registered tax return preparer competency examination. Small entities may be affected by these costs if the entities

choose to pay some or all of these fees for their employees.

Under the amendments to Circular 230, tax return preparers may also incur costs for exam preparation courses, plus incidental costs, such as for travel and accommodations, in order to obtain the designation of registered tax return preparer under Circular 230. Course prices can vary greatly, from free to hundreds of dollars. Many small tax return preparation firms may choose, as with the user fee, to bear these costs for their employees. In some cases, small entities may lose sales and profits while their employed tax return preparers attend exam preparation classes or are studying and sitting for the examination. Some small entities that employ tax return preparers may even need to alter their business operations if a significant number of their employees cannot satisfy the necessary registration and competency requirements. Treasury and the IRS conclude, however, that only a small percentage of small entities, if any, may need to cease doing business or radically change their business model due to these final regulations.

A description of the steps the agency has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes, including a statement of the factual, policy, and legal reasons for selecting any alternative adopted in the final rule and why other significant alternatives affecting the impact on small entities that the agency considered were rejected.

Treasury and the IRS are not aware of any steps that could be taken to minimize the economic impact on small entities that would also be consistent with the objectives of these final regulations and have determined that there is no viable alternative to these final regulations. These regulations do not impose any more requirements on small entities than are necessary to effectively administer the internal revenue laws. Further, the regulations do not subject small entities to any requirements that are not also applicable to larger entities covered by the regulations.

The IOAA authorizes the charging of user fees for agency services, subject to policies designated by the President. The OMB Circular implements presidential policies regarding user fees and encourages user fees when a government agency provides a special benefit to a member of the public. As Congress has not appropriated funds to the registered tax return preparer program, there are no viable alternatives to the imposition of user fees, which fees recover the costs to the IRS for providing the special benefits associated with the registered tax return preparer program.

Drafting Information

The principal author of these regulations is Emily M. Lesniak, Office of the Associate Chief Counsel (Procedure and Administration).

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 300 is amended as follows:

Part 300—USER FEES

Paragraph 1. The authority citation for part 300 continues to read in part as follows:

Authority: 31 U.S.C. 9701.

Par. 2. Section 300.0 is amended by redesignating paragraph (b)(12) as paragraph (b)(13) and adding new paragraph (b)(12) to read as follows:

§300.0 User fees; in general.

* * * * *

(b) * * *

(12) Taking the registered tax return preparer competency examination.

* * * * *

§300.12 **[Redesignated as §300.13]**

Par. 3. Redesignate §300.12 as §300.13.

Par. 4. Adding new §300.12 to read as follows:

§300.12 Registered tax return preparer competency examination fee.

(a) *Applicability*. This section applies to the competency examination to become a registered tax return preparer pursuant to 31 CFR 10.4(c).

(b) *Fee*. The fee for taking the registered tax return preparer competency examination is $27, which is the government cost for overseeing the examination and does not include any fees charged by the administrator of the examination.

(c) *Person liable for the fee*. The person liable for the competency examination fee is the applicant taking the examination.

(d) *Effective/applicability date*. This section is applicable beginning November 25, 2011.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved November 21, 2011.

Emily S. McMahon,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on November 22, 2011, 11:15 a.m., and published in the issue of the Federal Register for November 25, 2011, 76 F.R. 72619)

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461–4: Economic performance.

Recurring item exception to the all events test. This ruling clarifies the treatment of certain liabilities under the recurring item exception to the economic performance requirement under section 461(h)(3) of the Code. It also addresses the application of the "not material" and "better matching" requirement of the recurring item exception in the context of a lease and a service contract each having a term of one year. The ruling distinguishes contracts for the provision of services from insurance and warranty contracts and applies the recurring item exception differently. Rev. Proc. 2011–14 modified and amplified.

Rev. Rul. 2012–1

ISSUES

Under the situations described below:

(1) Is the amount of X's liability material for purposes of the recurring item exception in §461(h)(3) of the Internal Revenue Code if the liability accrues over more than one taxable year for financial accounting purposes?

(2) For purposes of the recurring item exception, does the accrual of X's liability

over more than one taxable year result in better matching of the liability with related income if X generates the related income in its trade or business over more than one taxable year and the liability accrues over more than one taxable year for financial accounting purposes?

(3) Is X's liability that arises under a service contract properly characterized as a "liability arising out of the provision of services" under § 1.461–4(d)(2), rather than a "liability arising out of the provision of a warranty or service contract" under § 1.461–4(g)(5)?

(4) Does the recurring item exception apply to X's liability to provide services pursuant to a service contract that is characterized as a "liability arising out of the provision of services" under § 1.461–4(d)(2)?

FACTS

X is a corporation that uses an accrual method of accounting, including the recurring item exception provided in § 461(h)(3) and § 1.461–5, for federal income tax purposes. *X* files its federal income tax returns on a calendar year basis and prepares annual financial statements in accordance with generally accepted accounting principles.

On July 1, 2011, *X* enters into a one-year lease agreement for property it will use in its trade or business to generate income over the period of the lease. The lease of the property begins on July 1, 2011, and continues through June 30, 2012. The terms of the lease agreement require *X* to pay $50,000, the entire balance of the lease liability, on July 1, 2011, and *X* pays the $50,000 on that date. *X*'s financial statements account for the lease agreement by recognizing the $50,000 expense ratably over the one-year period of the lease.

In conjunction with entering into the lease agreement, *X* also enters into a one-year service contract with a maintenance company unrelated to the lessor of the property. The service contract begins on July 1, 2011, and continues through June 30, 2012. Under the terms of the service contract, the maintenance company will inspect and clean the leased property monthly and provide any necessary repair and maintenance services relating to the normal wear and tear or routine maintenance of the property. The services to be provided to *X* under the service contract are general services to be provided on an ongoing and recurring basis. The terms of the service contract require *X* to pay $2,400, the entire balance of the liability, on July 1, 2011, and *X* pays the $2,400 on that date. *X*'s financial statements account for the service contract by recognizing the $2,400 expense as the services are provided over the one-year period of the contract.

X reasonably expects that it will enter into similar leases and service contracts on a recurring basis in the future.

LAW

Section 461(a) provides that the amount of any deduction or credit must be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461–1(a)(2)(i) provides that, under an accrual method of accounting, a liability is incurred, and generally taken into account for federal income tax purposes, in the taxable year in which (1) all the events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy (requirements (1) and (2) are collectively referred to as the "all events test"), and (3) economic performance has occurred with respect to the liability. See also § 1.446–1(c)(1)(ii)(A). All the events have occurred that establish the fact of the liability when (1) the event fixing the liability, whether that be the required performance or other event, occurs, or (2) payment is due, whichever happens earliest. Rev. Rul. 2007–3, 2007–1 C.B. 350; Rev. Rul. 80–230, 1980–2 C.B. 169; Rev. Rul. 79–410, 1979–2 C.B. 213, *amplified by* Rev Rul. 2003–90, 2003–2 C.B. 353.

Section 461(h)(1) and § 1.461–4(a)(1) provide that, for purposes of determining whether an accrual basis taxpayer can treat the amount of any liability as incurred, the all events test is not treated as met any earlier than the taxable year in which economic performance occurs with respect to the liability.

Section 1.461–4(d)(2)(i) provides that if the liability of a taxpayer arises out of the providing of services or property to the taxpayer by another person, economic performance occurs as the services or property is provided.

Section 1.461–4(d)(3)(i) provides that if the liability of a taxpayer arises out of the use of property by the taxpayer, economic performance occurs ratably over the period of time the taxpayer is entitled to the use of the property.

Section 1.461–4(g)(5) provides that if the liability of a taxpayer arises out of the provision to the taxpayer of insurance, or a warranty or service contract, economic performance occurs as payment is made to the person to which the liability is owed. A warranty or service contract is a contract that a taxpayer enters into in connection with property bought or leased by the taxpayer, pursuant to which the other party to the contract promises to replace or repair the property under specified circumstances. Section 1.461–4(g)(5)(i).

Section 461(h)(3)(A) and § 1.461–5(b) provide a recurring item exception to the general rule of economic performance. Under the recurring item exception, a liability is treated as incurred for a taxable year if: (i) at the end of the taxable year, all events have occurred that establish the fact of the liability and the amount can be determined with reasonable accuracy; (ii) economic performance occurs on or before the earlier of (a) the date that the taxpayer files a timely return (including extensions) for the taxable year, or (b) the 15th day of the ninth calendar month after the close of the taxable year; (iii) the liability is recurring in nature; and (iv) either (A) the amount of the liability is not material or (B) the accrual of the liability in the taxable year results in a better matching of the liability with the income to which it relates than would result from accruing the liability for the taxable year in which economic performance occurs. Section 461(h)(3)(B) provides that in making a determination under the materiality and matching requirements, the treatment of the liability on financial statements shall be taken into account.

Section 1.461–5(b)(4)(i) provides that in determining whether a liability is material, consideration is given to the amount of the liability in absolute terms and in relation to the amount of other items of income and expense attributable to the same activity. Section 1.461–5(b)(4)(ii) provides that a liability is material if it is material for financial statement purposes under gener-

ally accepted accounting principles. Section 1.461–5(b)(4)(iii) provides that a liability that is immaterial for financial statement purposes under generally accepted accounting principles may be material for purposes of the materiality requirement of the recurring item exception.

Section 1.461–5(b)(5)(i) provides that in determining whether the matching requirement of the recurring item exception is satisfied, generally accepted accounting principles are an important factor, but are not dispositive. Section 1.461–5(b)(5)(ii) provides that in the case of a liability described in § 1.461–4(g)(5) (insurance, warranty or service contract), the matching requirement of the recurring item exception is deemed satisfied.

ANALYSIS

Lease liability

On July 1, 2011, all the events have occurred that establish the fact of *X*'s lease liability (because *X*'s payment is due under the lease agreement on that date) and the amount of the lease liability can be determined with reasonable accuracy. Because the lease liability arises out of the use of property provided to *X*, economic performance occurs ratably over the period of time that *X* is entitled to use the property. Section 1.461–4(d)(3)(i). Therefore, unless the recurring item exception applies, *X*'s lease liability is incurred ratably over the one-year lease period beginning July 1, 2011 and ending June 30, 2012.

To apply the recurring item exception to its lease liability, *X* must, in part, demonstrate either that the lease liability is immaterial or that recognizing the liability in a year prior to the ratable use of the property results in a better matching of the expense to the related income. In determining whether a liability is immaterial, the legislative history of the recurring item exception provides:

> If an item is considered material for financial statement purposes, it will also be considered material for tax purposes. For example, assume that a calendar-year taxpayer enters into a one-year maintenance contract on July 1, 1985. If the amount of the expense is prorated between 1985 and 1986 for financial statement purposes, it should be prorated for tax purposes. If, however, the full amount is deducted in 1985 for financial statement purposes because it is not material under generally accepted accounting principles, it may (or may not) be considered an immaterial item for purposes of [the recurring item] exception.

H.R. Conf. Rep. 98–861, at 874 (1984) (original formatting omitted). The example in the legislative history makes clear that a liability is material under the recurring item exception if it is deemed sufficiently material for financial statement purposes so that it accrues over more than one taxable year.

Consistent with the legislative history, and with the directive in § 461(h)(3)(B) that the treatment of a liability on financial statements be taken into account, § 1.461–5(b)(4)(ii) provides that a liability is material if it is material for financial statement purposes under generally accepted accounting principles. Because *X*'s lease liability accrues over more than one taxable year for financial statement purposes under generally accepted accounting principles, the lease liability is material for purposes of applying the recurring item exception. Therefore, to apply the recurring item exception to its lease liability, *X* must demonstrate that recognizing the liability in a year prior to the ratable use of the property results in a better matching of the liability to the income to which it relates than would result from accrual of the liability in the taxable year in which economic performance occurs.

In determining whether the matching requirement of the recurring item exception is satisfied, the treatment of a liability on financial statements must be taken into account. Section 461(h)(3)(B). Generally accepted accounting principles are an important factor, but are not dispositive. Section 1.461–5(b)(5)(i). Accruing a liability over more than one taxable year results in better matching than accrual in a single, earlier year if: (1) the liability accrues over more than one taxable year for financial accounting purposes under generally accepted accounting principles; (2) the liability relates to income that a taxpayer generates in its trade or business over more than one taxable year; and (3) there are no overriding facts or circumstances that indicate accrual of the full liability in the earlier year results in a better match with the income.

X has determined that under generally accepted accounting principles, its lease liability should be recognized ratably over the period of the lease, and thus accrues the liability on its financial statements over the period of the lease. Furthermore, *X* uses the leased property in its trade or business to generate income over the period of the lease. In addition, absent overriding facts or circumstances that indicate that accrual in the earlier year would result in better matching, the accrual of the lease liability in a year prior to the satisfaction of economic performance will not result in a better matching of the liability with the related income as compared to accruing the liability for the taxable year in which economic performance occurs. Because *X*'s lease liability is material under § 1.461–5(b)(1)(iv)(A), and because it does not satisfy the matching requirement of § 1.461–5(b)(1)(iv)(B), *X* cannot use the recurring item exception to treat its lease liability as incurred in 2011.

Service Contract Liability

On July 1, 2011, all the events have occurred that establish the fact of *X*'s service contract liability (because *X*'s payment is due under the service contract on that date) and the amount of the service contract liability can be determined with reasonable accuracy. The applicable economic performance rule depends on whether the service contract liability arises out of the provision of services to *X* under § 1.461–4(d)(2)(i) (a "service liability"), or whether the liability arises out of the provision to *X* of a warranty or service contract under § 1.461–4(g)(5) (a "payment liability"). Further, the matching requirement of the recurring item exception applies differently depending on whether the service contract liability is a service liability under § 1.461–4(d)(2)(i) or a payment liability under § 1.461–4(g)(5).

Section 1.461–4(g)(5)(i) defines a warranty or service contract as a contract that a taxpayer enters into in connection with property bought or leased by the taxpayer, pursuant to which the other party to the contract promises to replace or repair the property under specified circumstances. The term "specified circumstances" implies the occurrence of a unique or irregular circumstance necessitating the repair or replacement of property. Thus, the war-

ranty and service contracts contemplated in § 1.461–4(g)(5) are similar to insurance contracts, which also are characterized by the occurrence of a unique or irregular circumstance necessitating the repair or replacement of property. The regulations recognize this similarity by treating insurance, warranty contracts, and service contracts collectively as a single category of payment liability under § 1.461–4(g)(5).

The service contracts addressed in § 1.461–4(g)(5)(i) are distinguishable from contracts for general services that are provided on an ongoing and recurring basis. This distinction is reinforced in the deemed matching rule of § 1.461–5(b)(5)(ii), which provides that the matching requirement is deemed satisfied only for certain payment liabilities, including service contract liabilities addressed in § 1.461–4(g)(5). Deemed matching for these types of liabilities is appropriate because a liability is triggered only by the occurrence of a unique or irregular circumstance. In contrast, a deemed matching rule would be inappropriate for services that are performed on an ongoing and recurring basis and contribute to the taxpayer's income-generating activities over a certain period.

The services to be provided to *X* under the terms of the service contract are general services to be provided on an ongoing and recurring basis rather than services to be provided only in "specified circumstances." Therefore, *X*'s service contract liability is a service liability under §1.461–4(d)(2)(i), rather than a payment liability under §1.461–4(g)(5), for purposes of applying the economic performance rules. Accordingly, under § 1.461–4(d)(2), economic performance of *X*'s service contract liability occurs as the services are provided to *X* over the term of the contract.

To apply the recurring item exception to its service contract liability, *X* must, in part, demonstrate either that its liability is not material or that recognizing the liability in a year prior to the performance of the services results in a better matching of the expense to the related income. In determining whether a liability is not material, § 461(h)(3)(B) provides that financial statement treatment is considered, and both the legislative history of § 461(h)(3) and § 1.461–5(b)(4)(ii) provide that a liability is material if it is material for financial statement purposes under generally accepted accounting principles. Because X's service contract liability accrues over more than one taxable year for financial statement purposes under generally accepted accounting principles, the liability is material for purposes of applying the recurring item exception. Therefore, to apply the recurring item exception to its service contract liability, *X* must demonstrate that recognizing the liability in a year prior to the performance of the services results in a better matching of the liability to the income to which it relates than would result from accruing the liability in the taxable year in which economic performance occurs. The deemed matching rule for certain payment liabilities in §1.461–5(b)(5)(ii) does not apply to *X*'s service contract liability because *X*'s liability does not arise out of the provision of a warranty or service contract under §1.461–4(g)(5).

In determining whether the matching requirement of the recurring item exception is satisfied, generally accepted accounting principles are an important factor, but not dispositive. Section 1.461–5(b)(5)(i). Under generally accepted accounting principles, *X* has determined that its service contract liability should be recognized as services are provided over the period of the contract. Furthermore, the services provided to *X* are used in the ongoing operation of X's trade or business to generate income over the period of the contract. Absent any other overriding facts or circumstances that would indicate better matching, the accrual of the service contract liability in a year prior to the satisfaction of economic performance will not result in a better matching of the liability with the related income as compared to accruing the liability for the taxable year in which economic performance occurs. Because *X*'s service contract liability is material under § 1.461–5(b)(1)(iv)(A), and because it does not satisfy the matching requirement of § 1.461–5(b)(1)(iv)(B), *X* cannot use the recurring item exception to treat its service contract liability as incurred in 2011.

Some contracts call for services to be performed on a recurring basis and for additional performance to be provided only in "specified circumstances." This revenue ruling does not address the tax treatment for a mixed service and warranty contract.

HOLDINGS

(1) For purposes of the recurring item exception in § 461(h)(3), the amount of *X*'s lease liability is material.

(2) For purposes of the recurring item exception, the accrual of *X*'s lease liability over more than one taxable year results in better matching of the liability with related income.

(3) *X*'s service contract liability is properly characterized as a liability arising out of the provision of services to the taxpayer under § 1.461–4(d)(2), rather than as a liability arising out of the provision to the taxpayer of a warranty or service contract under § 1.461–4(g)(5).

(4) The recurring item exception does not apply to *X*'s service contract liability.

APPLICATION

Any change in a taxpayer's method of accounting to conform to any of the holdings in this revenue ruling is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A taxpayer that wants to change its method of accounting to conform to any of the holdings in this ruling must follow the automatic change in accounting method provisions of Rev. Proc. 2011–14, 2011–4 C.B. 330, with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2011–14 do not apply to a taxpayer that wants to make the change for its first taxable year ending on or after December 13, 2011, provided an issue is not under consideration, as defined in section 3.09 of Rev. Proc. 2011–14, regarding whether all the events have occurred that establish the fact of the liability; and

(2) For purposes of section 6.02(4) of Rev. Proc. 2011–14, the taxpayer must include on line 1a of the Form 3115 the designated automatic accounting method change number "161."

EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011–14 is modified and amplified to include this automatic change in section 19 of the APPENDIX.

DRAFTING INFORMATION

The principal author of this revenue ruling is Charles H. Kim of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Charles H. Kim at (202) 622–5020 (not a toll-free call).

Part III. Administrative, Procedural, and Miscellaneous

2012 Standard Mileage Rates

Notice 2012–1

SECTION 1. PURPOSE

This notice provides the 2012 standard mileage rates for taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. This notice also provides the amount taxpayers must use in calculating reductions to basis for depreciation taken under the business standard mileage rate, and the maximum standard automobile cost that may be used in computing the allowance under a fixed and variable rate (FAVR) plan.

SECTION 2. BACKGROUND

Rev. Proc. 2010–51, 2010–51 I.R.B. 883, provides rules for computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes, and for substantiating, under § 274(d) of the Internal Revenue Code and § 1.274–5 of the Income Tax Regulations, the amount of ordinary and necessary business expenses of local transportation or travel away from home. Taxpayers using the standard mileage rates must comply with Rev. Proc. 2010–51.

An independent contractor conducts an annual study for the Internal Revenue Service of the fixed and variable costs of operating an automobile to determine the standard mileage rates for business, medical, and moving use reflected in this notice. The standard mileage rate for charitable use is set by § 170(i).

Notice 2010–88, 2010–51 I.R.B. 882, requested comments on the limitation in section 4.05(1) of Rev. Proc. 2010–51 on using the business standard mileage rate for five or more automobiles (such as in fleet operations). Only one responsive comment was received, which suggested extending the business standard mileage rate to larger fleets. After considering this comment, and in light of the limited number of comments, the Service has decided to make no changes to section 4.05(1) at this time.

SECTION 2. STANDARD MILEAGE RATES

The standard mileage rate for transportation or travel expenses is 55.5 cents per mile for all miles of business use (business standard mileage rate). See section 4 of Rev. Proc. 2010–51.

The standard mileage rate is 14 cents per mile for use of an automobile in rendering gratuitous services to a charitable organization under § 170. See section 5 of Rev. Proc. 2010–51.

The standard mileage rate is 23 cents per mile for use of an automobile (1) for medical care described in § 213, or (2) as part of a move for which the expenses are deductible under § 217. See section 5 of Rev. Proc. 2010–51.

SECTION 3. BASIS REDUCTION AMOUNT

For automobiles a taxpayer uses for business purposes, the portion of the business standard mileage rate treated as depreciation is 21 cents per mile for 2008 and 2009, 23 cents per mile for 2010, 22 cents per mile for 2011, and 23 cents per mile for 2012. See section 4.04 of Rev. Proc. 2010–51.

SECTION 4. MAXIMUM STANDARD AUTOMOBILE COST

For purposes of computing the allowance under a FAVR plan, the standard automobile cost may not exceed $28,000 for automobiles (excluding trucks and vans) or $29,300 for trucks and vans. See section 6.02(6) of Rev. Proc. 2010–51.

SECTION 5. EFFECTIVE DATE

This notice is effective for (1) deductible transportation expenses paid or incurred on or after January 1, 2012, and (2) mileage allowances or reimbursements paid to an employee or to a charitable volunteer (a) on or after January 1, 2012, and (b) for transportation expenses the employee or charitable volunteer pays or incurs on or after January 1, 2012.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Notice 2010–88, as modified by Ann. 2011–40, 2011–29 I.R.B. 56, is superseded.

DRAFTING INFORMATION

The principal author of this notice is Bernard P. Harvey of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information on this notice, contact Bernard P. Harvey at (202) 622–4930 (not a toll-free call).

Rev. Proc. 2012–9

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SECTION 1. WHAT IS THE PURPOSE OF THIS REVENUE PROCEDURE?

This revenue procedure sets forth procedures for issuing determination letters and rulings on the exempt status of organizations under §§ 501 and 521 of the Internal Revenue Code other than those subject to Rev. Proc. 2012–6, last bulletin (relating to pension, profit-sharing, stock bonus, annuity, and employee stock ownership plans). Generally, the Service issues these determination letters and rulings in response to applications for recognition of exemption from Federal income tax. These procedures also apply to revocation or modification of determination letters or rulings. This revenue procedure also provides guidance on the exhaustion of administrative remedies for purposes of declaratory judgment under § 7428 of the Code.

Description of terms used in this revenue procedure

.01 For purposes of this revenue procedure —

(1) The term "Service" means the Internal Revenue Service.

(2) The term "application" means the appropriate form or letter that an organization must file or submit to the Service for recognition of exemption from Federal income tax under the applicable section of the Internal Revenue Code. *See* section 3 for information on specific forms.

(3) The term "EO Determinations" means the office of the Service that is primarily responsible for processing initial applications for tax-exempt status. It includes the main EO Determinations office located in Cincinnati, Ohio, and other field offices that are under the direction and control of the Manager, EO Determinations. Applications are generally processed in the centralized EO Determinations office in Cincinnati, Ohio. However, some applications may be processed in other EO Determinations offices or referred to EO Technical.

(4) The term "EO Technical" means the office of the Service that is primarily responsible for issuing letter rulings to taxpayers on exempt organization matters, and for providing technical

advice or technical assistance to other offices of the Service on exempt organization matters. The EO Technical office is located in Washington, DC.

(5) The term "Appeals Office" means any office under the direction and control of the Chief, Appeals. The purpose of the Appeals Office is to resolve tax controversies, without litigation, on a fair and impartial basis. The Appeals Office is independent of EO Determinations and EO Technical.

(6) The term "determination letter" means a written statement issued by EO Determinations or an Appeals Office in response to an application for recognition of exemption from Federal income tax under §§ 501 and 521. This includes a written statement issued by EO Determinations or an Appeals Office on the basis of advice secured from EO Technical pursuant to the procedures prescribed herein and in Rev. Proc. 2012–5.

(7) The term "ruling" means a written statement issued by EO Technical in response to an application for recognition of exemption from Federal income tax under §§ 501 and 521.

(8) The term "Code" means the Internal Revenue Code.

Updated annually

.02 This revenue procedure is updated annually, but may be modified or amplified during the year.

SECTION 2. NATURE OF CHANGES AND RELATED REVENUE PROCEDURES

Rev. Proc. 2011–9 is superseded

.01 This revenue procedure is a general update of Rev. Proc. 2011–9, 2011–2 I.R.B. 283, which is hereby superseded.

Related revenue procedures

.02 This revenue procedure supplements Rev. Proc. 2012–10, this Bulletin, with respect to the effects of § 7428 of the Code on the classification of organizations under §§ 509(a) and 4942(j)(3). Rev. Proc. 80–27, 1980–1 C.B. 677, sets forth procedures under which exemption may be recognized on a group basis for subordinate organizations affiliated with and under the general supervision and control of a central organization. Rev. Proc. 72–5, 1972–1 C.B. 709, provides information for religious and apostolic organizations seeking recognition of exemption under § 501(d). General procedures for requests for a determination letter or ruling are provided in Rev. Proc. 2012–4. User fees for requests for a determination letter or ruling are set forth in Rev. Proc. 2012–8.

What changes have been made to Rev. Proc. 2011–9?

.03 Notable changes to Rev. Proc. 2011–9 that appear in this year's update include —

(1) Section 3.01 clarifies that Form 8718, *User Fee for Exempt Organization Determination Letter Request*, is not a determination letter application.

(2) A reference to § 501(r) is added to section 3.03 to cover hospitals seeking exemption under § 501(c)(3).

(3) Section 4.08 is added to describe existing practice that the Service may decline to issue a group exemption letter when appropriate in the interest of sound tax administration. *See* Rev. Proc. 2012–4, section 8.01.

(4) A new item (6) is added to section 12 to reflect revocation of exemption automatically pursuant to § 6033(j) for failure to file a required annual return or notice for three consecutive years.

SECTION 3. WHAT ARE THE PROCEDURES FOR REQUESTING RECOGNITION OF EXEMPT STATUS?

In general

.01 An organization seeking recognition of exempt status under § 501 or § 521 is required to submit the appropriate application. In the case of a numbered application form, the current version of the form must be submitted. A central organization that has previously received recognition of its own exemption can request a group exemption letter by submitting a letter application along with Form 8718, *User Fee for Exempt Organization Determination Letter Request. See* Rev. Proc. 80–27. Form 8718 is not a determination letter application. Attach this form to the determination letter application.

User fee

.02 An application must be submitted with the correct user fee, as set forth in Rev. Proc. 2012–8.

Form 1023 application

.03 An organization seeking recognition of exemption under § 501(c)(3) and § 501(e), (f), (k), (n), (q), or (r) must submit a completed Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. In the case of an organization that provides credit counseling services, see § 501(q) of the Code. In the case of an organization that is a hospital and is seeking exemption under § 501(c)(3), see § 501(r) of the Code.

Form 1024 application

.04 An organization seeking recognition of exemption under § 501(c)(2), (4), (5), (6), (7), (8), (9), (10), (12), (13), (15), (17), (19), or (25) must submit a completed Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, along with Form 8718. In the case of an organization that provides credit counseling services and seeks recognition of exemption under § 501(c)(4), see § 501(q) of the Code.

Letter application

.05 An organization seeking recognition of exemption under § 501(c)(11), (14), (16), (18), (21), (22), (23), (26), (27), (28), or (29), or under § 501(d), must submit a letter application along with Form 8718.

Form 1028 application

.06 An organization seeking recognition of exemption under § 521 must submit a completed Form 1028, *Application for Recognition of Exemption Under Section 521 of the Internal Revenue Code,* along with Form 8718.

Form 8871 notice for political organizations

.07 A political party, a campaign committee for a candidate for federal, state or local office, and a political action committee are all political organizations subject to tax under § 527. To be tax-exempt, a political organization may be required to notify the Service that it is to be treated as a § 527 organization by electronically filing Form 8871, *Political Organization Notice of Section 527 Status*. For details, go to the IRS website at *www.irs.gov/polorgs*.

Requirements for a substantially completed application

.08 A substantially completed application, including a letter application, is one that:

(1) is signed by an authorized individual;

(2) includes an Employer Identification Number (EIN);

(3) for organizations other than those described in § 501(c)(3), includes a statement of receipts and expenditures and a balance sheet for the current year and the three preceding years (or the years the organization was in existence, if less than four years), and if the organization has not yet commenced operations or has not completed one accounting period, a proposed budget for two full accounting periods and a current statement of assets and liabilities; for organizations described in § 501(c)(3), see Form 1023 and Notice 1382;

(4) includes a detailed narrative statement of proposed activities, including each of the fundraising activities of a § 501(c)(3) organization, and a narrative description of anticipated receipts and contemplated expenditures;

(5) includes a copy of the organizing or enabling document that is signed by a principal officer or is accompanied by a written declaration signed by an authorized individual certifying that the document is a complete and accurate copy of the original or otherwise meets the requirements of a "conformed copy" as outlined in Rev. Proc. 68–14, 1968–1 C.B. 768;

(6) if the organizing or enabling document is in the form of articles of incorporation, includes evidence that it was filed with and approved by an appropriate state official (*e.g.*, stamped "Filed" and dated by the Secretary of State); alternatively, a copy of the articles of incorporation may be submitted if accompanied by a written declaration signed by an authorized individual that the copy is a complete and accurate copy of the original copy that was filed with and approved by the state; if a copy is submitted, the written declaration must include the date the articles were filed with the state;

(7) if the organization has adopted by-laws, includes a current copy; the by-laws need not be signed if submitted as an attachment to the application for recognition of exemption; otherwise, the by-laws must be verified as current by an authorized individual; and

(8) is accompanied by the correct user fee and Form 8718, when applicable.

Terrorist organizations not eligible to apply for recognition of exemption

.09 An organization that is identified or designated as a terrorist organization within the meaning of § 501(p)(2) of the Code is not eligible to apply for recognition of exemption.

SECTION 4. WHAT ARE THE STANDARDS FOR ISSUING A DETERMINATION LETTER OR RULING ON EXEMPT STATUS?

Exempt status must be established in application and supporting documents

.01 A favorable determination letter or ruling will be issued to an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from Federal income tax is claimed.

Determination letter or ruling based solely on administrative record

.02 A determination letter or ruling on exempt status is issued based solely upon the facts and representations contained in the administrative record.

(1) The applicant is responsible for the accuracy of any factual representations contained in the application.

(2) Any oral representation of additional facts or modification of facts as represented or alleged in the application must be reduced to writing over the signature of an officer or director of the taxpayer under a penalties of perjury statement.

(3) The failure to disclose a material fact or misrepresentation of a material fact on the application may adversely affect the reliance that would otherwise be obtained through issuance by the Service of a favorable determination letter or ruling.

Exempt status may be recognized in advance of actual operations

.03 Exempt status may be recognized in advance of the organization's operations if the proposed activities are described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements for exemption pursuant to the section of the Code under which exemption is claimed.

(1) A mere restatement of exempt purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement.

(2) The organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

(3) Where the organization cannot demonstrate to the satisfaction of the Service that it qualifies for exemption pursuant to the section of the Code under which exemption is claimed, the

Service will generally issue a proposed adverse determination letter or ruling. *See also* section 7 of this revenue procedure.

No letter if exempt status issue in litigation or under consideration within the Service

.04 A determination letter or ruling on exempt status ordinarily will not be issued if an issue involving the organization's exempt status under § 501 or § 521 is pending in litigation, is under consideration within the Service, or if issuance of a determination letter or ruling is not in the interest of sound tax administration. If the Service declines to issue a determination or ruling to an organization seeking exempt status under § 501(c)(3), the organization may be able to pursue a declaratory judgment under § 7428, provided that it has exhausted its administrative remedies.

Incomplete application

.05 If an application does not contain all of the items set out in section 3.08 of this revenue procedure, the Service may return it to the applicant for completion.

(1) In lieu of returning an incomplete application, the Service may retain the application and request additional information needed for a substantially completed application.

(2) In the case of an application under § 501(c)(3) that is returned incomplete, the 270-day period referred to in § 7428(b)(2) will not be considered as starting until the date a substantially completed Form 1023 is refiled with or remailed to the Service. If the application is mailed to the Service and a postmark is not evident, the 270-day period will start to run on the date the Service actually receives the substantially completed Form 1023. The same rules apply for purposes of the notice requirement of § 508.

(3) Generally, the user fee will not be refunded if an incomplete application is filed. *See* Rev. Proc. 2012–8, section 10.

Even if application is complete, additional information may be required

.06 Even though an application is substantially complete, the Service may request additional information before issuing a determination letter or ruling.

(1) If the application involves an issue where contrary authorities exist, an applicant's failure to disclose and distinguish contrary authorities may result in requests for additional information, which could delay final action on the application.

(2) In the case of an application under § 501(c)(3), the period of time beginning on the date the Service requests additional information until the date the information is submitted to the Service will not be counted for purposes of the 270-day period referred to in § 7428(b)(2).

Expedited handling

.07 Applications are normally processed in the order of receipt by the Service. However, expedited handling of an application may be approved where a request is made in writing and contains a compelling reason for processing the application ahead of others. Upon approval of a request for expedited handling, an application will be considered out of its normal order. This does not mean the application will be immediately approved or denied. Circumstances generally warranting expedited processing include:

(1) a grant to the applicant is pending and the failure to secure the grant may have an adverse impact on the organization's ability to continue to operate;

(2) the purpose of the newly created organization is to provide disaster relief to victims of emergencies such as flood and hurricane; and

(3) there have been undue delays in issuing a determination letter or ruling caused by a Service error.

May decline to issue group exemption

.08 The Service may decline to issue a group exemption letter when appropriate in the interest of sound tax administration.

SECTION 5. WHAT OFFICES ISSUE AN EXEMPT STATUS DETERMINATION LETTER OR RULING?

EO Determinations issues a determination letter in most cases

.01 Under the general procedures outlined in Rev. Proc. 2012–4, EO Determinations is authorized to issue determination letters on applications for exempt status under §§ 501 and 521.

Certain applications referred to EO Technical

.02 EO Determinations will refer to EO Technical those applications that present issues which are not specifically covered by statute or regulations, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. In addition, EO Determinations will refer those applications that have been specifically reserved by revenue procedure or by other official Service instructions for handling by EO Technical for purposes of establishing uniformity or centralized control of designated categories of cases. EO Technical will notify the applicant organization upon receipt of a referred application, and will consider each such application and issue a ruling directly to the organization.

Technical advice may be requested in certain cases

.03 If at any time during the course of consideration of an exemption application by EO Determinations the organization believes that its case involves an issue on which there is no published precedent, or there has been non-uniformity in the Service's handling of similar cases, the organization may request that EO Determinations either refer the application to EO Technical or seek technical advice from EO Technical. *See* Rev. Proc. 2012–5, sections 4.04 and 4.05.

Technical advice must be requested in certain cases

.04 If EO Determinations proposes to recognize the exemption of an organization to which EO Technical had issued a previous contrary ruling or technical advice, EO Determinations must seek technical advice from EO Technical before issuing a determination letter. This does not apply where EO Technical issued an adverse ruling and the organization subsequently made changes to its purposes, activities, or operations to remove the basis for which exempt status was denied.

SECTION 6. WITHDRAWAL OF AN APPLICATION

Application may be withdrawn prior to issuance of a determination letter or ruling

.01 An application may be withdrawn upon the written request of an authorized individual at any time prior to the issuance of a determination letter or ruling. Therefore, an application may not be withdrawn after the issuance of a proposed adverse determination letter or ruling.

(1) When an application is withdrawn, the Service will retain the application and all supporting documents. The Service may consider the information submitted in connection with the withdrawn request in a subsequent examination of the organization.

(2) Generally, the user fee will not be refunded if an application is withdrawn. *See* Rev. Proc. 2012–8, section 10.

§ 7428 implications of withdrawal of application under § 501(c)(3)

.02 The Service will not consider the withdrawal of an application under § 501(c)(3) as either a failure to make a determination within the meaning of § 7428(a)(2) or as an exhaustion of administrative remedies within the meaning of § 7428(b)(2).

SECTION 7. WHAT ARE THE PROCEDURES WHEN EXEMPT STATUS IS DENIED?

Proposed adverse determination letter or ruling

.01 If EO Determinations or EO Technical reaches the conclusion that the organization does not satisfy the requirements for exempt status pursuant to the section of the Code under which exemption is claimed, the Service generally will issue a proposed adverse determination letter or ruling, which will:

(1) include a detailed discussion of the Service's rationale for the denial of tax-exempt status; and

(2) advise the organization of its opportunity to appeal or protest the decision and request a conference.

Appeal of a proposed adverse determination letter issued by EO Determinations

.02 A proposed adverse determination letter issued by EO Determinations will advise the organization of its opportunity to appeal the determination by requesting Appeals Office consideration. To do this, the organization must submit a statement of the facts, law and arguments in support of its position within 30 days from the date of the adverse determination letter. The organization must also state whether it wishes an Appeals Office conference. Any determination letter issued on the basis of technical advice from EO Technical may not be appealed to the Appeals Office on issues that were the subject of the technical advice.

Protest of a proposed adverse ruling issued by EO Technical

.03 A proposed adverse ruling issued by EO Technical will advise the organization of its opportunity to file a protest statement within 30 days and to request a conference. If a conference is requested, the conference procedures outlined in Rev. Proc. 2012–4, section 12, are applicable.

Final adverse determination letter or ruling where no appeal or protest is submitted

.04 If an organization does not submit a timely appeal of a proposed adverse determination letter issued by EO Determinations, or a timely protest of a proposed adverse ruling issued by EO Technical, a final adverse determination letter or ruling will be issued to the organization. The final adverse letter or ruling will provide information about the filing of tax returns and the disclosure of the proposed and final adverse letters or rulings.

How EO Determinations handles an appeal of a proposed adverse determination letter

.05 If an organization submits an appeal of the proposed adverse determination letter, EO Determinations will first review the appeal, and, if it determines that the organization qualifies for tax-exempt status, issue a favorable exempt status determination letter. If EO Determinations maintains its adverse position after reviewing the appeal, it will forward the appeal and the exemption application case file to the Appeals Office.

Consideration by the Appeals Office

.06 The Appeals Office will consider the organization's appeal. If the Appeals Office agrees with the proposed adverse determination, it will either issue a final adverse determination or, if a conference was requested, contact the organization to schedule a conference. At the end of the conference process, which may involve the submission of additional information, the Appeals Office will either issue a final adverse determination letter or a favorable determination letter. If the Appeals Office believes that an exemption or private foundation status issue is not covered by published precedent or that there is non-uniformity, the Appeals Office must request technical advice from EO Technical in accordance with Rev. Proc. 2012–5, sections 4.04 and 4.05.

If a protest of a proposed adverse ruling is submitted to EO Technical

.07 If an organization submits a protest of a proposed adverse exempt status ruling, EO Technical will review the protest statement. If the protest convinces EO Technical that the organization qualifies for tax-exempt status, a favorable ruling will be issued. If EO Technical maintains its adverse position after reviewing the protest, it will either issue a final adverse ruling or, if a conference was requested, contact the organization to schedule a conference. At the end of the conference process, which may involve the submission of additional information, EO Technical will either issue a final adverse ruling or a favorable exempt status ruling.

An appeal or protest may be withdrawn

.08 An organization may withdraw its appeal or protest before the Service issues a final adverse determination letter or ruling. Upon receipt of the withdrawal request, the Service will complete the processing of the case in the same manner as if no appeal or protest was received.

Appeal or protest and conference rights not applicable in certain situations

.09 The opportunity to appeal or protest a proposed adverse determination letter or ruling and the conference rights described above are not applicable to matters where delay would be prejudicial to the interests of the Service (such as in cases involving fraud, jeopardy, the imminence of the expiration of the statute of limitations, or where immediate action is necessary to protect the interests of the Government).

SECTION 8. DISCLOSURE OF APPLICATIONS AND DETERMINATION LETTERS AND RULINGS

Sections 6104 and 6110 of the Code provide rules for the disclosure of applications, including supporting documents, and determination letters and rulings.

Disclosure of applications, supporting documents, and favorable determination letters or rulings

.01 The applications, any supporting documents, and the favorable determination letter or ruling issued, are available for public inspection under § 6104(a)(1) of the Code. However, there are certain limited disclosure exceptions for a trade secret, patent, process, style of work, or apparatus, if the Service determines that the disclosure of the information would adversely affect the organization.

(1) The Service is required to make the applications, supporting documents, and favorable determination letters or rulings available upon request. The public can request this information by submitting Form 4506–A, *Request for Public Inspection or Copy of Exempt or Political Organization IRS Form.* Organizations should ensure that applications and supporting documents do not include unnecessary personal identifying information (such as bank account numbers or social security numbers) that could result in identity theft or other adverse consequences if publicly disclosed.

(2) The exempt organization is required to make its exemption application, supporting documents, and determination letter or ruling available for public inspection without charge. For more information about the exempt organization's disclosure obligations, see Publication 557, *Tax-Exempt Status for Your Organization.*

Disclosure of adverse determination letters or rulings

.02 The Service is required to make adverse determination letters and rulings available for public inspection under § 6110 of the Code. Upon issuance of the final adverse determination letter or ruling to an organization, both the proposed adverse determination letter or ruling and the final adverse determination letter or ruling will be released pursuant to § 6110.

(1) These documents are made available to the public after the deletion of names, addresses, and any other information that might identify the taxpayer. *See* § 6110(c) for other specific disclosure exemptions.

(2) The final adverse determination letter or ruling will enclose Notice 437, *Notice of Intention to Disclose,* and redacted copies of the final and proposed adverse determination letters or rulings. Notice 437 provides instructions if the organization disagrees with the deletions proposed by the Service.

Disclosure to State officials when the Service refuses to recognize exemption under § 501(c)(3)

.03 The Service may notify the appropriate State officials of a refusal to recognize an organization as tax-exempt under § 501(c)(3). *See* § 6104(c) of the Code. The notice to the State officials may include a copy of a proposed or final adverse determination letter or ruling the Service issued to the organization. In addition, upon request by the appropriate State official, the Service may make available for inspection and copying the exemption application and other information relating to the Service's determination on exempt status.

Disclosure to State officials of information about § 501(c)(3) applicants

.04 The Service may disclose to State officials the name, address, and identification number of any organization that has applied for recognition of exemption under § 501(c)(3).

SECTION 9. REVIEW OF DETERMINATION LETTERS BY EO TECHNICAL

Determination letters may be reviewed by EO Technical to assure uniformity

.01 Determination letters issued by EO Determinations may be reviewed by EO Technical, or the Office of the Associate Chief Counsel (Passthroughs and Special Industries) (for cases under § 521), to assure uniform application of the statutes or regulations, or rulings, court opinions, or decisions published in the Internal Revenue Bulletin.

Procedures for cases where EO Technical takes exception to a determination letter

.02 If EO Technical takes exception to a determination letter issued by EO Determinations, the manager of EO Determinations will be advised. If EO Determinations notifies the organization of the exception taken, and the organization disagrees with the exception, the file will be returned to EO Technical. The referral to EO Technical will be treated as a request for technical advice, and the procedures in Rev. Proc. 2012–5 will be followed.

SECTION 10. DECLARATORY JUDGMENT PROVISIONS OF § 7428

Actual controversy involving certain issues

.01 Generally, a declaratory judgment proceeding under § 7428 of the Code can be filed in the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia with respect to an actual controversy involving a determination by the Service or a failure of the Service to make a determination with respect to the initial or continuing qualification or classification of an organization under § 501(c)(3) (charitable, educational, etc.); § 170(c)(2) (deductibility of contributions); § 509(a) (private foundation status); § 4942(j)(3) (operating foundation status); or § 521 (farmers cooperatives).

Exhaustion of administrative remedies

.02 Before filing a declaratory judgment action, an organization must exhaust its administrative remedies by taking, in a timely manner, all reasonable steps to secure a determination from the Service. These include:

(1) the filing of a substantially completed application Form 1023 under § 501(c)(3) pursuant to section 3.08 of this revenue procedure, or the request for a determination of foundation status pursuant to Rev. Proc. 2012–10, this Bulletin, or its successor;

(2) in appropriate cases, requesting relief pursuant to Treas. Reg. § 301.9100–1 of the Procedure and Administration Regulations regarding the extension of time for making an election or application for relief from tax;

(3) the timely submission of all additional information requested by the Service to perfect an exemption application or request for determination of private foundation status; and

(4) exhaustion of all administrative appeals available within the Service pursuant to section 7 of this revenue procedure.

Not earlier than 270 days after seeking determination

.03 An organization will in no event be deemed to have exhausted its administrative remedies prior to the earlier of:

(1) the completion of the steps in section 10.02, and the sending by the Service by certified or registered mail of a final determination letter or ruling; or

(2) the expiration of the 270-day period described in § 7428(b)(2) in a case where the Service has not issued a final determination letter or ruling, and the organization has taken, in a timely manner, all reasonable steps to secure a determination letter or ruling.

Service must have reasonable time to act on an appeal or protest

.04 The steps described in section 10.02 will not be considered completed until the Service has had a reasonable time to act upon an appeal or protest, as the case may be.

Final determination to which § 7428 applies

.05 A final determination to which § 7428 of the Code applies is a determination letter or ruling, sent by certified or registered mail, which holds that the organization is not described in § 501(c)(3) or § 170(c)(2), is a public charity described in a part of § 509 or § 170(b)(1)(A) other than the part under which the organization requested classification, is not a private foundation as defined in § 4942(j)(3), or is a private foundation and not a public charity described in a part of § 509 or § 170(b)(1)(A).

SECTION 11. EFFECT OF DETERMINATION LETTER OR RULING RECOGNIZING EXEMPTION

Effective date of exemption

.01 A determination letter or ruling recognizing exemption is usually effective as of the date of formation of an organization if its purposes and activities prior to the date of the determination letter or ruling were consistent with the requirements for exemption. However, special rules under § 508(a) of the Code may apply to an organization applying for exemption under § 501(c)(3), and special rules under § 505(c) may apply to an organization applying for exemption under § 501(c)(9), (17), or (20).

(1) If the Service requires the organization to alter its activities or make substantive amendments to its enabling instrument, the exemption will be effective as of the date specified in a determination letter or ruling.

(2) If the Service requires the organization to make a nonsubstantive amendment, exemption will ordinarily be recognized as of the date of formation. Examples of nonsubstantive amendments include correction of a clerical error in the enabling instrument or the addition of a dissolution clause where the activities of the organization prior to the determination letter or ruling are consistent with the requirements for exemption.

Reliance on determination letter or ruling

.02 A determination letter or ruling recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization, or a change in the applicable law. Also, a determination letter or ruling may not be relied upon if it was based on any inaccurate material factual representations. *See* section 12.01.

SECTION 12. REVOCATION OR MODIFICATION OF DETERMINATION LETTER OR RULING RECOGNIZING EXEMPTION

A determination letter or ruling recognizing exemption may be revoked or modified: (1) by a notice to the taxpayer to whom the determination letter or ruling was issued; (2) by enactment of legislation or ratification of a tax treaty; (3) by a decision of the Supreme Court of the United States; (4) by the issuance of temporary or final regulations; (5) by the issuance of a revenue ruling, revenue procedure, or other statement published in the Internal Revenue Bulletin; or (6) automatically, pursuant to § 6033(j), for failure to file a required annual return or notice for three consecutive years.

Revocation or modification of a determination letter or ruling may be retroactive

.01 The revocation or modification of a determination letter or ruling recognizing exemption may be retroactive if there has been a change in the applicable law, the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or, in the case of organizations to which § 503 of the Code applies, engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purpose and such transaction involved a substantial part of the corpus or income of such organization. In certain cases an organization may seek relief from retroactive revocation or modification of a determination letter or ruling under § 7805(b). Requests for § 7805(b) relief are subject to the procedures set forth in Rev. Proc. 2012–4.

(1) Where there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change.

(2) In the case where a determination letter or ruling is issued in error or is no longer in accord with the Service's position and § 7805(b) relief is granted (*see* sections 13 and 14 of Rev. Proc. 2012–4), ordinarily, the revocation or modification will be effective not earlier than the date when the Service modifies or revokes the original determination letter or ruling.

Appeal and conference procedures in the case of revocation or modification of exempt status letter

.02 In the case of a revocation or modification of a determination letter or ruling, the appeal and conference procedures are generally the same as set out in section 7 of this revenue procedure, including the right of the organization to request that EO Determinations or the Appeals Office seek technical advice from EO Technical. However, appeal and conference rights are not applicable to matters where delay would be prejudicial to the interests of the Service (such as in cases involving fraud, jeopardy, the imminence of the expiration of the statute of limitations, or where immediate action is necessary to protect the interests of the Government).

(1) If the case involves an exempt status issue on which EO Technical had issued a previous contrary ruling or technical advice, EO Determinations generally must seek technical advice from EO Technical.

(2) EO Determinations does not have to seek technical advice if the prior ruling or technical advice has been revoked by subsequent contrary published precedent or if the proposed revocation involves a subordinate unit of an organization that holds a group exemption letter issued by EO Technical, the EO Technical ruling or technical advice was issued under the Internal

Revenue Code of 1939 or prior revenue acts, or if the ruling was issued in response to Form 4653, *Notification Concerning Foundation Status.*

SECTION 13. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 2011–9 is superseded.

SECTION 14. EFECTIVE DATE

This revenue procedure is effective January 9, 2012.

SECTION 15. PAPERWORK REDUCTION ACT

The collection of information for a letter application under section 3.05 of this revenue procedure has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–2080. All other collections of information under this revenue procedure have been approved under separate OMB control numbers.

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

The collection of this information is required if an organization wants to be recognized as tax-exempt by the Service. We need the information to determine whether the organization meets the legal requirements for tax-exempt status. In addition, this information will be used to help the Service delete certain information from the text of an adverse determination letter or ruling before it is made available for public inspection, as required by § 6110.

The time needed to complete and file a letter application will vary depending on individual circumstances. The estimated average time is 10 hours.

Books and records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. The rules governing the confidentiality of letter applications are covered in § 6104.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Mr. Dave Rifkin and Mr. Matt Perdoni of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the TE/GE Customer Service office at (877) 829–5500 (a toll-free call), or send an e-mail to *tege.eo@irs.gov* and include "Question about Rev. Proc. 2012–9" in the subject line.

SECTION 1. PURPOSE AND SCOPE

The purpose of this revenue procedure is to set forth updated procedures of the Internal Revenue Service (the "Service") with respect to issuing rulings and determination letters on private foundation status under § 509(a) of the Internal Revenue Code (the "Code"), operating foundation status under § 4942(j)(3), and exempt operating foundation status under § 4940(d)(2), of organizations exempt from Federal income tax under § 501(c)(3). This revenue procedure also applies to the issuance of determination letters on the foundation status under § 509(a)(3) of nonexempt charitable trusts described in § 4947(a)(1).

SECTION 2. WHAT CHANGES HAVE BEEN MADE TO REV. PROC. 2011–10?

.01 This revenue procedure is a general update of Rev. Proc. 2011–10, 2011–2 I.R.B. 294.

.02 Section 6.02 is rewritten to reflect changes since the introduction of Form 8940, *Request for Miscellaneous Determination Under Section 507, 509(a), 4940, 4942, 4945, and 6033 of the Internal Revenue Code*, and the Instructions for Form 8940. Refer to Form 8940 and the Instructions for Form 8940 for information about the types of requests that require the filing of a Form 8940.

SECTION 3. BACKGROUND

.01 All § 501(c)(3) organizations are classified as private foundations under § 509(a) unless they qualify as a public charity under § 509(a)(1) (which cross-references § 170(b)(1)(A)(i)-(vi)), (2), (3), or (4). *See* Treas. Reg. §§ 1.170A–9, 1.509(a)–1 through 1.509(a)–7. The Service determines an organization's private foundation or public charity status when the organization files its Form 1023. This status will be included in the organization's determination letter.

.02 In its Form 990, *Return of Organization Exempt From Income Tax Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)*, a public charity indicates the paragraph of § 509(a), and subparagraph of § 170(b)(1)(A), if applicable, under which it qualifies as a public charity. Because of changes in its activities or operations, this may differ from the public charity status listed in its original determination letter. Although an organization is not required to obtain a determination letter to qualify for the new public charity status, in order for Service records to recognize any change in public charity status, an organization must obtain a new determination of foundation status pursuant to this revenue procedure.

.03 If a public charity no longer qualifies as a public charity under § 509(a)(1)-(4), then it becomes a private foundation, and as such, it must file Form 990–PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*. It is not necessary for the organization to obtain a determination letter on its new private foundation status (although it is permitted to do so pursuant to this revenue procedure). The organization indicates this change in foundation status by filing its Form 990–PF return and following any procedures specified in the form, instructions, or other published guidance. Thereafter, the organization may terminate its private foundation status, such as by giving notice and qualifying as a public charity again under § 509(a)(1)-(3) during a 60-month termination period in accordance with the procedures under § 507(b)(1)(B) and Treas. Reg. § 1.507–2(b).

.04 This revenue procedure applies to organizations that may have erroneously determined that the organization was a private foundation and wish to correct the error. For example, an organization may have erroneously classified an item or items in its calculation of public support, causing the organization to classify itself as a private foundation and to file Forms 990–PF. Pursuant to this revenue procedure, the organization can request to be classified as a public charity by showing that it continuously met the public support tests during the relevant periods. *See* section 7 below

.05 A private foundation may qualify as an operating foundation under § 4942(j)(3) without a determination letter from the Service, but the Service will not recognize such status in its records without a determination letter from the Service. An organization claiming to be an exempt operating foundation under § 4940(d)(2) must obtain a determination letter from the Service recognizing such status to be exempt from the § 4940 tax on net investment income.

SECTION 4. DETERMINATIONS OF FOUNDATION STATUS

.01 EO Determinations will issue determination letters on foundation status, including whether an organization is:

(1) a private foundation;

(2) a public charity described in §§ 509(a)(1) and 170(b)(1)(A) (other than clauses (v), (vii), and (viii));

(3) a public charity described in § 509(a)(2) or (4);

(4) a public charity described in § 509(a)(3), whether such organization is described in § 509(a)(3)(B)(i), (ii), or (iii) ("supporting organization type"), and whether or not a Type III supporting organization is functionally integrated;

(5) a private operating foundation described in § 4942(j)(3); or

(6) an exempt operating foundation described in § 4940(d)(2).

.02 EO Determinations will also issue determination letters on whether a nonexempt charitable trust described in § 4947(a)(1) is described in § 509(a)(3).

.03 EO Determinations will issue such determinations in response to applications for recognition of exempt status under § 501(c)(3), submitted by organizations pursuant to § 508(b). EO Determinations will also issue such determinations in response to separate requests for determination of foundation status submitted on Form 8940, *Request for Miscellaneous Determination*, pursuant to Rev. Proc. 2012–10 or its successor revenue procedures.

SECTION 5. APPLICABILITY OF ANNUAL REVENUE PROCEDURES

.01 Rev. Proc. 2012–9 (updated annually) provides procedures of the Service in processing applications for recognition of exemption from Federal income tax under § 501(c)(3). Rev. Proc. 2012–4 (updated annually) governs requests for rulings and determination letters. Rev. Proc. 2012–8 (updated annually) prescribes user fees for

applications, rulings, and other determinations. Except as specifically noted herein, those revenue procedures and their annual successors also apply to requests for determinations of foundation status.

.02 The provisions of Rev. Proc. 2012–9 and any successor revenue procedure regarding § 7428, protest, conference, and appeal rights also apply to all determinations of foundation status described in section 4.01 (except section 4.01(6) relating to exempt operating foundation status) and section 4.02, whether or not the request for determination is made in connection with an application for recognition of tax-exempt status.

.03 Where the issue of exemption under § 501(c)(3) is referred to EO Technical for decision under the procedures of Rev. Proc. 2012–9, the foundation status issue will be referred along with it.

SECTION 6. GENERALLY NO NEW DETERMINATION LETTER IF SAME STATUS IS SOUGHT

The Service generally will not issue a new determination letter to a taxpayer that seeks a determination of private foundation status that is identical to its current foundation status as determined by the Service. For example, an organization that is already recognized as described in §§509(a)(1) and 170(b)(1)(A)(ii) as a school generally will not receive a new determination letter that it is still described in §§ 509(a)(1) and 170(b)(1)(A)(ii) under the currently extant facts. However, the organization in such case could request a letter ruling, pursuant to Rev. Proc. 2012–4, that a given change of facts and circumstances will not adversely affect its status under §§ 509(a)(1) and 170(b)(1)(A)(ii).

SECTION 7. FORMAT OF REQUEST

.01 Organizations that are seeking to change their foundation status, including requests from public charities for private foundation status and requests from public charities to change from one public charity classification to another public charity classification, or seeking a determination or a change as to supporting organization type or functionally integrated status, or seeking operating foundation or exempt operating foundation status, must submit Form 8940, *Request Miscellaneous Determination Under Section 507, 509(a), 4940, 4942, 4945, and 6033 of the Internal Revenue Code*, along with all information, documentation, and other materials required by Form 8940 and the instructions thereto, as well as the appropriate user fee pursuant to Rev. Proc. 2012–8 or its successor revenue procedures.

.02 For complete information about filing requirements and the submission process, refer to Form 8940 and the Instructions for Form 8940.

SECTION 8. REQUESTS BY NONEXEMPT CHARITABLE TRUSTS

.01 A nonexempt charitable trust described in § 4947(a)(1) seeking a determination that it is described in § 509(a)(3) should submit a written request for a determination pursuant to Rev. Proc. 2012–4 or its successor revenue procedure.

.02 The request for determination must include the following information items, from the date that the organization became described in § 4947(a)(1) (but not before October 9, 1969) to the present:

(1) A subject line or other indicator on the first page of the request in bold, underlined, or all capitals font indicating "NONEXEMPT CHARITABLE TRUST REQUEST FOR DETERMINATION THAT IT IS DESCRIBED IN § 509(a)(3)";

(2) The name, address, and Employer Identification Number of the beneficiary organizations, together with a statement whether each such beneficiary organization is described in § 509(a)(1) or (2);

(3) A list of all of the trustees that have served, together with a statement stating whether such trustees were disqualified persons within the meaning of § 4946(a) (other than as foundation managers);

(4) A copy of the original trust instrument and all subsequently adopted amendments to that instrument;

(5) Sufficient information to otherwise establish that the trust has met the requirements of § 509(a)(3) as provided for in Treas. Reg. § 1.509(a)–4 (other than § 1.509(a)–4(i)(4)); If the trust did not qualify under § 509(a)(3) in one or more prior years (after October 9, 1969) in which it was described in § 4947(a)(1), then it cannot be issued a § 509(a)(3) determination letter except in accordance with the procedures for termination of private foundation status under § 507(b)(1)(B); and

(6) Such other information as is required for a determination under Rev. Proc. 2012–4 or any successor revenue procedure.

SECTION 9. DETERMINATIONS OPEN TO PUBLIC INSPECTION

Determinations and rulings as to foundation status are open to public inspection pursuant to § 6104(a).

SECTION 10. NOT APPLICABLE TO PRIVATE FOUNDATION TERMINATIONS UNDER § 507 OR CHANGES OF STATUS PURSUANT TO EXAMINATION

These procedures do not apply to a private foundation seeking to terminate its status under § 507. These procedures also do not apply to the examination of an organization which results in changes to its foundation status.

SECTION 11. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 2011–10 is superseded.

SECTION 12. EFFECTIVE DATE

This revenue procedure is effective January 9, 2012.

SECTION 13. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–1520.

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

The collections of information in this revenue procedure are in sections 7.02 and 8.02. This information is required to evaluate and process the request for a letter

ruling or determination letter. The collections of information are required to obtain a letter ruling or determination letter. The likely respondents are tax-exempt organizations.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Mr. Dave Rifkin and Mr. Matt Perdoni of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information about this revenue procedure, contact Customer Account Services at 877–829–5500. Dave Rifkin or Matt Perdoni can be reached by e-mail at *tege.eo@irs.gov*. Please include "Question about Rev. Proc. 2012–10" in the subject line.

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26 CFR 601.601: Rules and regulations.
(Also: 31 USC 330, 31 CFR 10.6, 31 CFR 10.9.)

Rev. Proc. 2012–12

SECTION 1. PURPOSE

The purpose of this revenue procedure is to describe the procedures and standards that organizations must follow to be identified by the Internal Revenue Service as a qualifying organization that may accredit continuing education providers under section 10.9(a)(1)(iii) of Circular 230. This revenue procedure also describes the standards for a continuing education provider under section 10.9(a)(1) and the procedures that individuals and entities must follow to be approved by the Internal Revenue Service as a continuing education provider under section 10.9(a)(1)(iv).

SECTION 2. BACKGROUND

.01 On June 3, 2011, the Treasury Department and the Internal Revenue Service published final regulations in the Federal Register (T.D. 9527, 2011–28 I.R.B. 38 [76 FR 32286]) under 31 CFR Part 10 (reprinted as Treasury Department Circular 230) that require registered tax return preparers to complete continuing education offered by qualified continuing education providers. Enrolled agents and enrolled retirement plan agents also are required to complete continuing education under Circular 230. Section 10.9(a)(1) of Circular 230 provides that continuing education providers must be:

(i) An accredited educational institution;

(ii) Recognized for continuing education purposes by the licensing body of any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia;

(iii) Recognized and approved by a qualifying organization as a provider of continuing education on subject matters within section 10.6(f) of Circular 230; or

(iv) Recognized by the IRS as a professional organization, society, or business whose programs include offering continuing professional education opportunities in subject matters within section 10.6(f).

For purposes of this revenue procedure, an entity referred to as a "qualifying organization" in section 10.9(a)(1)(iii) will be referred to as an "accrediting organization" and an individual or entity approved by the IRS as a continuing education provider under section 10.9(a)(1)(iv) will be referred to as a "section iv CE provider."

.02 Section 10.9(a)(1)(iii) provides that the IRS, at its discretion, may identify the accrediting organizations that maintain minimum education standards comparable to those set forth in Circular 230 in appropriate forms, instructions, and other appropriate guidance.

.03 Section 10.9(a)(1)(iv) provides that the IRS, at its discretion, may require section iv CE providers to file an agreement and/or obtain IRS approval of each program as a qualified continuing education program in appropriate forms, instructions, or other appropriate guidance.

.04 Under section 10.9(a)(2), a continuing education provider must obtain a continuing education provider number and pay any applicable user fee. A continuing education provider also must maintain its status as a continuing education provider during each continuing education provider cycle by renewing its continuing education provider number as prescribed by forms, instructions, or other appropriate guidance and paying any applicable user fee.

.05 Sections 10.6(f) and 10.9(a)(3) provide initial criteria that continuing education programs must meet to qualify for continuing education credit for enrolled agents, enrolled retirement plan agents, and registered tax return preparers. A qualifying continuing education program generally must enhance professional knowledge in Federal taxation or Federal tax related matters, including ethics, must be consistent with the Internal Revenue Code and effective tax administration, and must be conducted by a qualified instructor.

.06 On July 18, 2011, Treasury and the IRS published Notice 2011–61 soliciting the feedback of education providers, tax return preparers, the associated industry and consumer groups, and taxpayers on the procedures and standards that will govern the process for identifying accrediting organizations or for those individuals and entities seeking approval as section iv CE providers. Numerous comments were received and were taken into account in the development of the standards and procedures prescribed in this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to any organization seeking to be identified as an accrediting organization or any individual or entity seeking approval as a section iv CE provider; and applies to any continuing education provider seeking to obtain continuing education provider and program numbers under section 10.9. This revenue procedure supplements sections 10.6 and 10.9 by describing the specific standards and procedures that those organizations, individuals, and entities must follow to be identified as an accrediting organization or accepted as a continuing education provider.

SECTION 4. ACCREDITING ORGANIZATIONS

.01 *Standards*. Any organization seeking to be identified as an accrediting organization that may approve individuals and entities as continuing education providers under section 10.9(a)(1)(iii) must:

(1) Have an established framework and effective means of review and approval for continuing education providers.

(2) Publish requirements for continuing education provider approval.

(3) Have written procedures sufficient to ensure that the continuing education providers it accredits comply with any standards set forth in Circular 230, the requirements described in section 5.02

below, and any other standards prescribed by the IRS in other appropriate guidance.

(4) Have experience evaluating continuing education providers in Federal taxation or Federal tax related matters, including ethics. The minimum level of experience required typically will be two years.

(5) Have an established process for annually auditing or reviewing selected programs of selected approved continuing education providers. Reviews of selected programs must be performed periodically, at least annually.

(6) Maintain records for each approved continuing education provider for four years and submit reports to the IRS periodically on the individuals and entities applying for continuing education provider status.

(7) Maintain an internet listing of all continuing education providers approved by the accrediting organization.

(8) Employ at least one full-time staff member with subject-matter expertise in Federal taxation or Federal tax related matters, including ethics. That staff member must be qualified to evaluate continuing education provider programs as outlined in Circular 230.

.02 *Requirements*. Any organization identified as an accrediting organization must:

(1) Comply with all IRS guidance and requirements, including Circular 230. The IRS may require an accrediting organization to provide additional information regarding such compliance. The IRS may revoke an organization's status as an accrediting organization if the organization fails to adequately and timely respond to the IRS's request for information.

(2) Have an established process for in-depth reviews of selected approved continuing education providers on an annual basis.

(3) Act only as an approver of continuing education providers, and not offer Federal tax related continuing education commercially.

(4) Respond to IRS requests for information regarding the individuals or entities approved or not approved as continuing education providers.

.03 *How to Apply*. An organization seeking to be identified as an accrediting organization authorized to approve individuals and entities as continuing education providers may apply by providing the information set forth in section 4.04 below. The applicant must include all relevant information required by this revenue procedure, including how the organization meets the standards described in section 4.01 above, in the application. Completed applications must be sent to:

Internal Revenue Service
Attention: RPO Continuing
Education Program
Rm. 7238 IR
1111 Constitution Ave., NW
Washington, DC 20224

Applicants will be notified, in writing, whether the application has been approved. Only after an applicant has received written notification of approval from the IRS may the accrediting organization begin accepting applications from individuals or entities seeking to become a continuing education provider under section 10.9(a)(1)(iii). Individuals or entities approved by the accrediting organization as a continuing education provider under section 10.9(a)(1)(iii) must obtain a provider number and program number(s) from the IRS by filing a completed Form 8498, *Continuing Education Provider Application and Request for Provider Number*, (and pay any applicable fee) online at *www.irs.gov/taxpros/ce* or they may request a paper application by calling the IRS Continuing Education Provider Processing Center at 1–855–296–3150 (toll-free) in the United States or 202–499–5606 (not a toll-free call) outside the United States. The processing time for a paper application will be six to eight weeks. Continuing education providers who have been approved by an accrediting organization may offer continuing education for purposes of section 10.6 only after they have received a continuing education provider number and program number(s) from the IRS, and followed all applicable procedures prescribed by the IRS.

An accrediting organization must renew its status as an accrediting organization every three calendar years as prescribed in forms, instructions, or other appropriate guidance. The renewal period will be from July through September of the applicable renewal year.

.04 *Required Information*. Any organization seeking to be identified as an accrediting organization that may approve individuals and entities as continuing education providers under section 10.9(a)(1)(iii) must provide the following information, including any supporting documentation, in its application to be identified as an accrediting organization:

(1) Full name, mailing address, telephone number, and web address (URL) of the organization.

(2) Tax identification number of the organization.

(3) Name and contact information of the organization's point of contact, including mailing address, telephone number, and e-mail address.

(4) Description of the requirements an individual or entity must meet to obtain the organization's approval as a continuing education provider. Supporting documentation must be attached.

(5) Description of the organization's experience and qualifications evaluating continuing education providers.

(6) Description of the process the organization uses to review applications it receives from continuing education providers and to ensure that continuing education providers will comply with the standards set forth in Circular 230, requirements described in section 5.02 below, and any other standards prescribed by the IRS in other appropriate guidance. Supporting documentation must be attached.

(7) Statement that the organization will not directly or indirectly offer continuing education in Federal tax matters or ethics commercially during any period that the organization is operating as an accrediting organization.

(8) Statement that the organization agrees to comply with all IRS guidance and requirements, including Circular 230.

(9) Statement that the organization acknowledges that its status as an IRS accrediting organization is subject to review at any time by the IRS, including but not limited to, IRS requests for information about the organization's review and approval process, interviews, and site visitations (including site visitations of the organization's approved continuing education providers). Statement also must acknowledge that the organization's failure to provide any data or information requested by the IRS or its denial of an IRS site visitation may result in suspension or

revocation of its accrediting organization status.

(10) Signed and dated statement by the organization's point of contact (see section 4.04(3)) or an officer, partner, member, or owner of the organization providing that the individual has examined and read the application and all accompanying information and to the best of the individual's knowledge and belief, the information provided is true, correct, and complete. The statement must be made under penalties of perjury and acknowledge that any false or misleading information may result in criminal penalties and/or the denial or termination of the organization's status as an accrediting organization.

SECTION 5. CONTINUING EDUCATION PROVIDERS

.01 *General*. Individuals or entities approved as a continuing education provider under section 10.9(a)(1)(i), (ii), or (iii) are required to obtain and renew annually a continuing education provider number. These continuing education providers also are required to obtain continuing education program numbers for each qualifying program they intend to offer. Continuing education providers may obtain and renew their continuing education provider numbers and program numbers by submitting a completed Form 8498, *Continuing Education Provider Application and Request for Provider Number*, online at *www.irs.gov/taxpros/ce* or they may request a paper application by calling the IRS Continuing Education Provider Processing Center at 1–855–296–3150 (toll-free) in the United States or 202–499–5606 (not a toll-free call) outside the United States. The processing time for a paper application will be six to eight weeks. Continuing education providers may be required to pay a reasonable annual fee to the third-party vendor who administers this program for the IRS. The third-party vendor will not charge an additional fee if a continuing education provider adds programs during a calendar year.

Individuals or entities approved as a continuing education provider may be required, as prescribed by the IRS and the third-party vendor, to provide identifying information of preparer tax identification number holders who successfully complete programs with IRS program numbers.

Continuing education providers must have a current or otherwise valid continuing education provider number prior to advertising that programs offered by the provider may be used to meet any IRS continuing education requirements. Additionally, any program offered by a continuing education provider must have a current or otherwise valid program number before the continuing education provider advertises that the program meets IRS requirements for continuing education.

.02 *Requirements*. Any individual or organization approved as a continuing education provider must:

(1) Offer continuing education programs designed to enhance professional knowledge in Federal taxation or Federal tax related matters, including ethics, consistent with the Internal Revenue Code and principles of effective tax administration.

a) If the continuing education program will be offered for the purpose of qualifying for continuing education credit for registered tax return preparers, the program must directly relate to the preparation of Federal tax returns or Federal tax ethics.

b) If the continuing education program will be offered for the purpose of qualifying for continuing education credit for enrolled retirement plan agents, the program must enhance the participant's professional knowledge in qualified retirement plan matters, including ethics.

Continuing education programs focused primarily on state tax related matters generally will not be eligible for continuing education credit unless the instructional material demonstrates that the program is designed to illustrate the difference between state law and Federal law in the same tax related matter. Providers offering continuing education programs with only limited professional benefit not designed to improve skills related to Federal tax related matters will not be approved.

(2) Provide continuing education program content that is accurate, current, and effectively designed to communicate content through program materials, activities, and delivery systems, whether classroom-based, computer-based, or for self-study.

(3) Use continuing education program presenters, instructors, discussion leaders, and speakers who have subject-matter expertise in Federal taxation or Federal tax related matters, including ethics, as well as demonstrable teaching and communication skills.

(4) Comply with any standards set forth in Circular 230 and any other standards prescribed by the IRS in other appropriate guidance.

(5) Ensure that all continuing education programs are developed and written by individual(s) with expertise in Federal tax related matters, or ethics in the case of an ethics program.

(6) Provide continuing education programs that utilize materials specifically developed for instructional use. General professional literature or IRS publications and reference manuals may be used only to supplement specific program materials.

(7) Review and update programs periodically, at least annually, to ensure accuracy and consistency with currently accepted standards relating to the program's subject matter. This review must be conducted by a qualified individual to ensure that the program is current, technically accurate, and addresses the stated learning objectives.

(8) Provide a means for evaluation of attendees' successful completion of the program. Providers must ensure that self-study programs include verification of completion of required material and demonstrated mastery of program content.

(9) Develop programs that meet the standards of Circular 230 for continuing education credit earned upon completion, based upon the standard of 50 minutes of contact time required for 1 continuing education credit earned. Credit is granted only for a full contact hour of 50 minutes, or multiples thereof; no credit will be awarded for partial continuing education consisting of less than 50 minutes of contact time.

(10) Collect and maintain reliable records to document participation and attendance, and issue certificates with IRS program numbers to students upon successful completion.

(11) Provide for voluntary program evaluations by individuals who have completed the program. The provider must ensure that participants have an opportunity to provide feedback concerning the quality and knowledge of the speaker/instructor, the quality of program materials, and whether the program met stated objectives. Any participant evaluations

received by the provider must be made available to the IRS on request.

.03 *How to Apply to Become a Section IV CE Provider*. Individuals or entities that do not meet the requirements of section 10.9(a)(1)(i), (ii), or (iii) may apply to the IRS for approval as a section iv CE provider. An applicant under section 10.9(a)(1)(iv) must apply for status as a section iv CE provider by submitting a completed Form 8498, *Continuing Education Provider Application and Request for Provider Number*, online at *www.irs.gov/taxpros/ce* or these individuals or entities may request a paper application by calling the IRS Continuing Education Provider Processing Center at 1–855–296–3150 (toll-free) in the United States or 202–499–5606 (not a toll-free call) outside the United States. The processing time for a paper application will be six to eight weeks. The applicant also must pay any applicable third-party vendor fee with the application and include all relevant information required in the application, including how the section iv CE provider meets the requirements described in section 5.02 above. Approved applicants will receive a continuing education provider number and program numbers and must renew their status annually in accordance with section 5.01 above.

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 of 1995 (44 U.S.C. 3507(d)) under control number 1545–1726.

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

The collection of information in this revenue procedure is in sections 4 and 5. This information is required in order for the IRS to ensure that individuals and organizations permitted to provide continuing education or accredit others to provide continuing education meet all of the appropriate procedures and standards for education in Federal tax practice. The likely respondents are individuals and organizations that want to provide continuing education or accredit others to provide continuing education.

The estimated total annual reporting or recordkeeping burden is 2,750 hours.

The estimated annual burden per respondent/recordkeeper varies from .6 hours to 1 hour, depending on individual circumstances, with an estimated average of .75 hours. The estimated number of respondents or recordkeepers is 3,000.

The estimated frequency of responses (used for reporting requirements only) under section 4 is once every three years; the estimated frequency of responses under section 5 is twice annually.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective December 6, 2011.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Janet Engel Kidd of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue procedure, contact Janet Engel Kidd at (202) 622–4940 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Application of the Segregation Rules to Small Shareholders

REG–149625–10

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 382 of the Internal Revenue Code (Code). These proposed regulations provide guidance regarding the application of the segregation rules to public groups under section 382 of the Code. These regulations affect corporations.

DATE: Written or electronic comments and requests for a public hearing must be received by February 21, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–149625–10), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–149625–10), 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–149625–10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Stephen R. Cleary, (202) 622–7750; concerning submission of comments or to request a public hearing, Oluwafunmilayo (Funmi) P. Taylor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

1. *Segregation and Aggregation — Statute, Legislative History, and Current Regulations*

Section 382 imposes a limitation on a corporation's use of net operating loss carryovers following a change in ownership. The legislative history explains that a limitation is necessary following a change in ownership because new shareholders otherwise would have an opportunity to contribute income-producing assets (or divert income opportunities) to the corporation, thus inappropriately accelerating the use of net operating loss carryovers. The section 382 limitation is intended to prevent a corporation from obtaining greater loss utilization than it could have achieved absent a change in ownership. S. Rep. No. 99–313 at 232 (1986).

A loss corporation has an ownership change if the percentage of stock of a loss corporation that is owned by one or more 5-percent shareholders has increased by more than 50 percentage points over the lowest percentage of stock of the loss corporation owned by such shareholders at any time during the testing period (generally, a three-year period). For purposes of section 382, the attribution rules of section 318(a)(2) apply, without limitation, to treat individuals as the owners of loss corporation stock. Pursuant to section 382(g)(4)(A), individual shareholders who own less than five percent of a loss corporation are aggregated and treated as a single 5-percent shareholder (a public group).

The regulations extend the public group concept to situations in which a loss corporation is owned by one or more entities, as defined in §1.382–3(a) (generally, partnerships, corporations, estates, and trusts). If an entity directly or indirectly owns five percent or more of the loss corporation, that entity has its own public group if its owners who are not 5-percent shareholders own, in the aggregate, five percent or more of the loss corporation. (Such an entity is referred to as a 5-Percent Entity in this preamble.)

The segregation rules, which are generally contained in §1.382–2T(j), and the exceptions thereto, which are generally contained in §1.382–3(j), apply to certain transactions affecting ownership by the loss corporation's direct public group and by the public groups of a 5-Percent Entity. The application of the segregation rules results in the creation of a new public group in addition to the one (or more) that existed previously. That new group is treated as a new 5-percent shareholder that increases its ownership interest in the loss corporation.

Section 382(g)(4)(B) mandates application of the segregation rules to transactions constituting equity structure shifts of the loss corporation. Generally, equity structure shifts are acquisitive asset reorganizations and recapitalizations under section 368. Section 382(g)(3)(B) provides regulatory authority to treat public offerings and similar transactions as equity structure shifts. Pursuant to that authority, the current segregation rules, subject to the cash issuance and small issuance exceptions (described in this preamble), treat issuances of stock under section 1032, redemptions, and redemption-like transactions as segregation events. The segregation rules also apply to transfers of loss corporation stock by an individual 5-percent shareholder to public shareholders and a 5-Percent Entity's transfer of loss corporation stock to public shareholders.

The small issuance and cash issuance exceptions exempt certain amounts of stock issuances from the segregation rules. Generally, the small issuance exception exempts the total amount of stock issued during a taxable year to the extent it does not exceed 10 percent of the total value of the corporation's outstanding stock at the beginning of the taxable year or 10 percent of the class of stock issued and outstanding at the beginning of the taxable year (the small issuance limitation). However, the small issuance exception does not apply to any issuance of stock that, by itself, exceeds the small issuance limitation. If stock is issued solely for cash, the cash issuance exception exempts a percentage of the total stock issued equal to 50 percent of the aggregate percentage ownership interest of the public groups of the cor-

poration immediately before the issuance. In determining the size of the issuance for this purpose, stock issued to 5-percent shareholders is taken into account. If the small issuance exception excludes only a portion of a stock issuance, the cash issuance exception may apply to the portion not excluded under the small issuance exception. Pursuant to a grant of regulatory authority in section 382(m)(4), the small issuance exception can apply to recapitalizations, but otherwise, neither exception applies to equity structure shifts.

2. *Notice 2010–49*

Notice 2010–49, 2010–27 I.R.B. 10, invited public comment relating to possible modifications to the regulations under section 382 regarding the treatment of shareholders who are not 5-percent shareholders (Small Shareholders). See §601.601(d)(2)(ii)(b).

Notice 2010–49 describes two general approaches — the Ownership Tracking Approach and the Purposive Approach — and sets forth some of the policy considerations underlying each approach. Both approaches recognize that a primary abuse section 382 seeks to prevent involves an acquisition of loss corporation stock followed by the contribution of income-producing assets or the diversion of income-producing opportunities to the corporation. The two approaches differ, however, in the extent they seek to identify and limit their effect to circumstances in which that abuse is most likely to occur.

Under the Ownership Tracking Approach, generally it is of no significance whether the shareholders who increase their ownership are Small Shareholders or 5-percent shareholders. This approach ensures that abusive transactions are addressed by tracking all changes in ownership without regard to their particular circumstances. Thus, any transaction that allows the corporation to track the increase in ownership interests held by Small Shareholders results in the segregation of Small Shareholders into a new public group, which is treated as a 5-percent shareholder. However, the Ownership Tracking Approach makes a concession to administrative convenience and acknowledges that "public trading," which is the purchase by one Small Shareholder of stock from another Small Shareholder, should not be taken into account because it is unduly burdensome for a corporation to take into account all such transactions. See §1.382–2T(e)(1)(ii).

Consistent with the purpose of section 382, the Purposive Approach seeks to identify more specifically the circumstances in which abuses are likely to arise. This approach reflects the view that it is unnecessary to take into account all readily identifiable acquisitions of stock by Small Shareholders, because Small Shareholders generally are not in a position to acquire loss corporation stock in order to contribute income-producing assets or divert income-producing opportunities.

The current regulations primarily reflect the Ownership Tracking Approach. Although certain provisions may seem to follow the Purposive Approach, their justification is nevertheless based upon the Ownership Tracking Approach. For example, the cash issuance exception of §1.382–3(j)(3) reduces the segregation effect of an issuance of stock to Small Shareholders but is justified on the grounds that there is likely to be substantial overlap between Small Shareholders who acquire stock in such an issuance and the Small Shareholders who already own stock.

Explanation of Provisions

1. *Overview*

The IRS and the Treasury Department received a range of comments in response to Notice 2010–49. Some comments endorsed substantial changes to the existing regulations, while others supported changes within the existing regulatory framework. One commenter supporting more modest changes to the existing regulations suggested that an overhaul of the current regulations likely would produce new uncertainties and complexities. Additionally, the comment observed that revisions allowing substantial infusions of capital into a loss corporation without section 382 implications would be counter to section 382 policies.

After consideration of the comments received, these regulations propose revisions following the Purposive Approach within the existing regulatory framework. Consistent with the Purposive Approach, these proposed regulations are intended to lessen the administrative burden and section 382 implications associated with transactions that are unlikely to implicate section 382 policy concerns. In general, these proposed regulations employ objective criteria to implement the Purposive Approach. The IRS and the Treasury Department believe that, where practicable, objective rules best serve the interests of loss corporations that desire certainty with respect to their section 382 positions, and best serve the interests of the government in fairly and consistently administering a complex statutory scheme.

Comments that embraced a more fundamental reform of the existing regulations were not incorporated into this proposal primarily because the approaches introduced significant subjectivity. For example, one commenter suggested that, subject to an anti-abuse rule, the segregation rules should not apply to redemption transactions. Another commenter suggested that if certain stock issuances and redemptions of Small Shareholders are sufficiently related, those transactions should be treated as public trading. These suggestions were not incorporated in favor of proposals that will provide greater certainty of result to the government and to loss corporations.

2. *Proposed Revisions*

A. *Inapplicability of the Segregation Rules to Certain Secondary Transfers*

Several of the comments supported rendering the segregation rules inoperative to transfers of loss corporation stock to Small Shareholders by 5-Percent Entities or individuals who are 5-percent shareholders. These comments also supported relief from the segregation rules for transactions in which an ownership interest in a 5-Percent Entity is transferred to a public owner or a 5-percent owner who is not a 5-percent shareholder.

The IRS and the Treasury Department agree that adoption of these exceptions is appropriate because these transactions do not introduce new capital into the loss corporation and because direct or indirect ownership of the loss corporation becomes less concentrated, thus diminishing the opportunity for loss trafficking. Furthermore, limiting the creation of additional public groups where loss trafficking is not implicated simplifies tax compliance and administration. Accordingly, these

proposed regulations generally render the segregation rules inoperative to transfers of loss corporation stock to Small Shareholders by 5-Percent Entities or individuals who are 5-percent shareholders. In these cases, the stock transferred will be treated as being acquired proportionately by the public groups existing at the time of the transfer. This rule also applies to transfers of ownership interests in 5-Percent Entities to public owners and to 5-percent owners who are not 5-percent shareholders.

B. *Inapplicability of the Segregation Rules to Certain Redemptions*

Two of the comments supported limiting application of the segregation rules in the case of redemptions. These commenters observed that, generally, a loss corporation's redemption of its stock from Small Shareholders does not raise loss trafficking concerns because (i) the capital of the loss corporation is contracting, and (ii) Small Shareholders generally cannot traffic in losses. One comment supported a rule that would, subject to an anti-abuse rule, render the segregation rules inapplicable to all redemptions. In addition to supporting the inapplicability of the segregation rules to all redemptions, the comment supported an objective rule for exempting redemptions based upon the mechanics of the small issuance exception.

In general, these proposed regulations adopt a rule based upon the mechanics of the small issuance exception to obviate the need for a subjective anti-abuse rule. Like the small issuance exception, this exception for redemptions exempts from segregation, at the loss corporation's option, either 10 percent of the total value of the loss corporation's stock at the beginning of the taxable year, or 10 percent of the number of shares of the redeemed class outstanding at the beginning of the taxable year. Where this exception applies, each public group existing immediately before the redemption will be treated as redeeming its proportionate share of exempted stock.

Like the small issuance exception, the small redemption exception will allow a loss corporation to plan its affairs as of the beginning of each taxable year. Furthermore, consistent with the Purposive Approach, the exception reduces administrative burden and the section 382 impact of transactions in which the abuses that section 382 is intended to prevent are unlikely to arise.

C. *Inapplicability of the Segregation Rules to 5-Percent Entities in Certain Circumstances*

One commenter expressed the need for relief from tracking shifts of ownership by Small Shareholders of 5-Percent Entities. The comment expressed that, in many cases, a loss corporation cannot obtain information relating to this ownership — either because the entity chooses not to respond or because the entity is prohibited from sharing information regarding its owners with the loss corporation. The inability to obtain this information may restrict capital-raising activities beyond what section 382 requires, because the loss corporation may choose to make worst-case assumptions about shifts in ownership when the relevant information cannot be obtained. The IRS and the Treasury Department agree that it is appropriate to provide relief in situations in which tracking shifts in ownership by Small Shareholders does not further the policy objectives of section 382. Furthermore, the IRS and the Treasury Department recognize that application of the segregation rules and the exceptions thereto present compliance issues for taxpayers and issues of tax administration for the government. Accordingly, these proposed regulations limit the situations in which the segregation rules apply to situations that potentially implicate the policies underlying section 382.

Under these proposed regulations, the segregation rules will not apply to a transaction if, on a testing date on which the rules would otherwise apply (i) the 5-Percent Entity owns ten percent or less (by value) of all the outstanding stock of the loss corporation (the ownership limitation), and (ii) the 5-Percent Entity's direct or indirect investment in the loss corporation does not exceed 25 percent of the entity's gross assets (the asset threshold). For purposes of the asset threshold, the entity's cash and cash items within the meaning of section 382(h)(3)(B)(ii) are not taken into account. Generally, the loss corporation may establish the ownership limitation through either actual knowledge or, absent actual knowledge to the contrary, the presumptions regarding stock ownership in §1.382–2T(k)(1).

The IRS and the Treasury Department believe that the proposal strikes an appropriate balance between reducing complexity and safeguarding section 382 policies. The proposal will enable loss corporations to disregard indirect changes in its ownership that may, under the current regulations, require burdensome information gathering and may unnecessarily impede the loss corporation's ability to reorganize its affairs. At the same time, however, the proposal imposes criteria that protect the government's interests. The asset threshold makes it unlikely that the loss corporation's attributes motivate transactions in the equity of 5-Percent Entities. Additionally, like the small issuance exception and the relief for redemptions that appears elsewhere in this proposal, the ownership limitation makes it unlikely that transactions among Small Shareholders one or more tiers removed from the loss corporation implicate loss trafficking concerns. (Note that the asset threshold and the ownership limitation do not apply to the exception for secondary transfers described elsewhere in this preamble because secondary transfers do not implicate the same policy concerns as transactions in which loss corporations can obtain additional capital.)

D. *Clarification of §1.382–2T(j)(3)*

Section 1.382–2T(j)(3) provides that, in general, the segregation rules apply to sales of loss corporation stock by individual 5-percent shareholders and by first tier entities. This section further provides that the "principles" of the foregoing apply to "transactions in which an ownership interest in a higher tier entity that owns five percent or more of the loss corporation (without regard to §1.382–2T(h)(2)(i)(A)) or a first tier entity is transferred to a public owner or a 5-percent owner who is not a 5-percent shareholder." This proposed regulation clarifies that the segregation rules apply to such a transfer only if the seller indirectly owns five percent or more of the loss corporation. In the case of a sale by an entity, ownership is determined without regard to §1.382–2T(h)(2)(i)(A).

E. *Small Issuance and Cash Issuance Exceptions*

Several of the comments requested expansion of the small issuance and cash issuance exceptions as a percentage of stock that is exempted from the segregation rules. Some of these comments also suggested that the cash issuance exception should apply to issuances of stock for non-cash property, including debt.

As previously discussed, transactions that infuse new capital into a loss corporation are of particular concern to section 382 policies because the capital infusion can accelerate the use of tax attributes. This is the case even if the new investors are Small Shareholders. Moreover, in its current form, the cash issuance exception dilutes the owner shifts that are attributable to capital-raising transactions.

The IRS and the Treasury Department request comments as to whether further refinement of either or both of these exceptions might be warranted in the context of any potential expansion of the exceptions proposed in this document.

F. *Coordinated Acquisitions*

Questions have arisen concerning the application of §1.382–3(a), which provides, in part, that a group of persons making a coordinated acquisition of stock can constitute an entity for purposes of section 382. Adding additional distinctions between larger and smaller shareholders, as proposed here, will increase the significance of this provision. The IRS and the Treasury Department are interested in comments as to circumstances under which a group of investors should be aggregated into a single entity based on their understandings or communications with each other or with third persons, such as the loss corporation or an underwriter.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. The certification is based on the fact that this rule would not impose new burdens on small entities and in fact, may reduce the recordkeeping burden on small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Request for a Public Hearing

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

Drafting Information

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

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.382–3 also issued under 26 U.S.C. 382(g)(4)(C) and 26 U.S.C. 382(m). * * *

Par. 2. Section 1.382–3 is amended as follows:

1. Adding paragraph (i).

2. Revising the heading of paragraph (j) and the introductory text of paragraph (j)(1).

3. Redesignating paragraphs (j)(13) and (j)(14) as (j)(16) and (j)(17).

4. Adding new paragraphs (j)(13) through (j)(14).

5. Adding new *Examples* 5, 6, 7, 8, 9, 10, 11, and 12 to newly redesignated paragraph (j)(16).

6. Revising newly redesignated paragraph (j)(17).

The revisions and additions read as follows:

§1.382–3 Definitions and rules relating to a 5-percent shareholder.

* * * * *

(i) *Segregation rules applicable to transactions involving first tier or higher tier entities*—(1) *In general*. The last sentence of §1.382–2T(j)(3)(i) applies only if the transferor of the ownership interest indirectly owns five percent or more of the loss corporation. If the transferor is an entity, ownership is determined without regard to the application of §1.382–2T(h)(2)(i)(A).

(2) *Effective/Applicability date*. This paragraph (i) applies to testing dates occurring on or after the date these regulations are published as final regulations in the **Federal Register**.

(j) *Modification of the segregation rules of §1.382–2T(j)(2)(iii) and (3)*—(1) *Introduction*. This paragraph (j) exempts, in whole or in part, certain transfers of stock from the segregation rules of §1.382–2T(j)(2)(iii) and (3). Terms and nomenclature used in this paragraph (j), and not otherwise defined herein, have the same meanings as in section 382 and the regulations issued under section 382.

* * * * *

(13) *Secondary transfer exception*. The segregation rules of §1.382–2T(j)(3)(i) will not apply to the transfer of a direct ownership interest in the loss corporation by a first tier entity or an individual that owns five percent or more of the loss

corporation to public shareholders. Instead, each public group existing at the time of the transfer will be treated under §1.382–2T(j)(3)(i) as acquiring its proportionate share of the stock exempted from the application of §1.382–2T(j)(3)(i). The segregation rules also will not apply if an ownership interest in an entity that owns five percent or more of the loss corporation (determined without regard to the application of §1.382–2T(h)(2)(i)(A)) is transferred by either a 5-percent owner that is a 5-percent shareholder or a higher tier entity owning five percent or more of the loss corporation (determined without regard to the application of §1.382–2T(h)(2)(i)(A)), provided that the transferee is either a public owner or a 5-percent owner who is not a 5-percent shareholder. Instead, each public group of the entity existing at the time of the transfer is treated under §1.382–2T(j)(3)(i) as acquiring its proportionate share of the transferred ownership interest.

(14) *Small redemption exception*—(i) *In general*. Section 1.382–2T(j)(2)(iii)(C) does not apply to a small redemption (as defined in paragraph (j)(14)(ii) of this section), except to the extent that the total amount of stock redeemed in that redemption and all other small redemptions previously made in the same taxable year (determined in each case on redemption) exceeds the small redemption limitation. This paragraph (j)(14) does not apply to a redemption of stock that, by itself, exceeds the small redemption limitation.

(ii) *Small redemption defined*. *Small redemption* means a redemption of public shareholders by the loss corporation of an amount of stock not exceeding the small redemption limitation.

(iii) *Small redemption limitation*—(A) *In general*. For each taxable year, the loss corporation may, at its option, apply this paragraph (j)(14)—

(*1*) On a corporation-wide basis, in which case the small redemption limitation is 10 percent of the total value of the loss corporation's stock outstanding at the beginning of the taxable year (excluding the value of stock described in section 1504(a)(4)); or

(*2*) On a class-by-class basis, in which case the small redemption limitation is 10 percent of the number of shares of the class redeemed that are outstanding at the beginning of the taxable year.

(B) *Class of stock defined*. For purposes of this paragraph (j)(14)(iii), a class of stock includes all stock with the same material terms.

(C) *Adjustments for stock splits and similar transactions*. Appropriate adjustments to the number of shares of a class outstanding at the beginning of a taxable year must be made to take into account any stock split, reverse stock split, stock dividend to which section 305(a) applies, recapitalization, or similar transaction occurring during the taxable year.

(D) *Exception*. The loss corporation may not apply this paragraph (j)(14)(iii) on a class-by-class basis if, during the taxable year, more than one class of stock is redeemed in a single redemption (or in two or more redemptions that are treated as a single redemption under paragraph (j)(14)(v) of this section).

(E) *Short taxable years*. In the case of a taxable year that is less than 365 days, the small redemption limitation is reduced by multiplying it by a fraction, the numerator of which is the number of days in the taxable year, and the denominator of which is 365.

(iv) *Proportionate redemption of exempted stock*—(A) *In general*. Each direct public group that exists immediately before a redemption to which this paragraph (j)(14) applies is treated as having been redeemed of its proportionate share of the amount of stock exempted from the application of §1.382–2T(j)(2)(iii)(C) under this paragraph (j)(14).

(B) *Actual knowledge of greater redemption*. Under the last sentence of §1.382–2T(k)(2), the loss corporation may treat direct public groups existing immediately before a redemption to which this paragraph (j)(14) applies as having been redeemed of more stock than the amount determined under paragraph (j)(14)(iv)(A) of this section, but only if the loss corporation actually knows that the amount redeemed from those groups in the redemption exceeds the amount so determined.

(v) *Certain related redemptions*. For purposes of this paragraph (j)(14), two or more redemptions (including redemptions of stock by first tier or higher tier entities) are treated as a single redemption if—

(A) The redemptions occur at approximately the same time pursuant to the same plan or arrangement; or

(B) A principal purpose of redeeming the stock in separate redemptions rather than in a single redemption is to minimize or avoid an owner shift under the rules of this paragraph (j)(14).

(vi) *Certain non-stock ownership interests*. As the context may require, a non-stock ownership interest in an entity other than a corporation is treated as stock for purposes of this paragraph (j)(14).

(15) *Exception for first tier and higher tier entities*—(i) *In general*. The segregation rules of §1.382–2T(j)(3)(iii) will not apply if, after taking into account the results of such transaction and all other transactions occurring on that date—

(A) The first tier or higher tier entity owns 10 percent or less (by value) of all the outstanding stock (without regard to §1.382–2(a)(3)) of the loss corporation; and

(B) The entity's direct or indirect investment in the loss corporation does not exceed 25 percent of the entity's gross assets. For this purpose, the entity's cash and cash items within the meaning of section 382(h)(3)(B)(ii) are not taken into account.

(ii) *Special Rules*. If paragraph (j)(15)(i) applies to combine one or more public groups, then—

(A) the amount of increase in the percentage of stock ownership of the continuing public group will be the sum of its increase and a proportionate amount of any increase by any public group that is combined with the continuing public group (the former public group); and

(B) the continuing public group's lowest percentage ownership will be the sum of its lowest percentage ownership and a proportionate amount of the former public group's lowest percentage ownership.

(iii) *Ownership of the loss corporation*. In making the determination under paragraph (j)(15)(i)(A) of this section—

(A) The rules of §1.382–2T(h)(2) will not apply;

(B) The entity will be treated as owning the loss corporation stock that it actually owns, and any loss corporation stock if that stock would be attributed to the entity under section 318(a) (without regard to paragraph (4) thereof unless an option is treated as exercised under §1.382–4(d)); and

(C) The operating rules of paragraph (j)(15)(iv) of this section will apply.

(iv) *Operating Rules*. Subject to the principles of §1.382–2T(k)(4), a loss corporation may establish the ownership limitation of paragraph (j)(15)(i)(A) of this section through either—

(A) Actual knowledge; or

(B) Absent actual knowledge to the contrary, the presumptions regarding stock ownership in §1.382–2T(k)(1).

(16) *Examples*. * * *

* * * * *

Example 5. Secondary transfer exception to segregation rules — no new public group. (i) *Facts*. L is owned 60 percent by one public group (Public L_1) and 40 percent by another public group (Public L_2). On July 1, 2010, A acquires 10 percent of L's stock over a public stock exchange. On December 31, 2010, A sells all of his L stock over a public stock exchange. No individual or entity acquires as much as five percent of L's stock as a result of A's disposition of his L stock. On January 3, 2011, B acquires 10 percent of L's stock over a public stock exchange. On June 30, 2011, B sells all of her L stock over a public stock exchange. No individual or entity acquires as much as five percent of L's stock as a result of B's disposition of her L stock.

(ii) *Analysis*. The dispositions of the L stock by A and B are not transactions that cause the segregation of L's direct public groups that exist immediately before the transaction (Public L_1 and Public L_2). When A and B sell their shares to public shareholders over the public stock exchange, the shares are treated as being reacquired by Public L_1 and Public L_2. As a result, Public L_1's ownership interest is treated as increasing from 54 percent to 60 percent during the testing period, and Public L_2's ownership interest is treated as increasing from 36 percent to 40 percent during the testing period.

Example 6. Secondary transfer exception — first tier entity. (i) *Facts*. L has a single class of common stock outstanding that is owned 60 percent by a direct public group (Public L) and 40 percent by P. P is owned 20 percent by Individual A and 80 percent by a direct public group (Public P). On October 6, 2013, A sells 50 percent of his interest in P to B, an individual who is a member of Public P.

(ii) *Analysis*. P is an entity that owns five percent or more of L. A is a 5-percent owner of P that is a 5-percent shareholder of L. Because A's sale of the P stock is to a member of Public P, the disposition of the P stock by A is not a transaction that causes the segregation of P's direct public group that exists immediately before the transaction (Public P). See paragraph (j)(13) of this section. When A sells his shares to B, the shares are treated as being acquired by Public P. As a result, Public P's ownership interest in L is treated as increasing from 32 percent to 36 percent during the testing period.

Example 7. Small redemption exception. (i) *Facts*. L is a calendar year taxpayer. On January 1, 2010, L has 1,060 shares of a single class of common stock outstanding, all of which are owned by a single direct public group (Public L). On July 1, 2010, L acquires 60 shares of its stock for cash. On December 31, 2010, in an unrelated redemption, L acquires 90 more shares of its stock for cash. Following each redemption, L's stock is owned entirely by public shareholders. No other changes in the ownership of L's stock occur prior to December 31, 2010.

(ii) *Analysis*. The July redemption is a small redemption because the number of shares redeemed (60) does not exceed 106, the small redemption limitation (10 percent of the number of common shares outstanding on January 1, 2010). Under paragraph (j)(14) of this section, the segregation rules of §1.382–2T(j)(2)(iii)(C) do not apply to the July redemption. Under paragraph (j)(14)(iv) of this section, Public L is treated as having all 60 shares redeemed.

(iii) The December redemption is a small redemption because the number of shares redeemed (90) does not exceed 106, the small redemption limitation (10 percent of the number of common shares outstanding on January 1, 2010). However, under paragraph (j)(14)(i) of this section, only 46 of the 90 shares redeemed are exempted from the segregation rules of §1.382–2T(j)(2)(iii)(C) because the total number of shares of common stock redeemed in the July and December redemptions exceeds 106, the small redemption limitation, by 44. Accordingly, under paragraph (j)(14)(iv) of this section, Public L is treated as having 46 shares redeemed in the December redemption. Section 1.382–2T(j)(2)(iii)(C) applies to the remaining 44 shares redeemed. Accordingly, Public L is segregated into two different public groups immediately before the transaction (and thereafter) so that the redeemed interests (Public RL) are treated as part of a public group that is separate from the ownership interests that are not redeemed (Public CL). Therefore, as a result of the December redemption, Public CL's interest in L increases by 4.4 percentage points (from 95.6 percent (956/1,000) to 100 percent (910/910)) on the December 31, 2010 testing date. For purposes of determining whether an ownership change occurs on any subsequent testing date having a testing period that includes such redemption, Public CL is treated as a 5-percent shareholder whose percentage ownership interests in L increased by 4.4 percentage points as a result of the redemption.

Example 8. Segregation rules inapplicable — proportionate amount. (i) *Facts*. P_1 is a corporation that owns 8 percent of the stock of L. The remaining L stock (92 percent) is owned by Public L. P_1 is entirely owned by Public P_1. Excluding cash and cash items within the meaning of section 382(h)(3)(B)(ii), P_1's investment in L represents 11 percent of P_1's gross assets. P_2 is a corporation owned 90 percent by individual A and 10 percent by a public group (Public P_2). On May 22, 2013, P_1 merges into P_2 with the shareholders of P_1 receiving an amount of P_2 stock equal to 25 percent of the value of P_2 immediately after the reorganization. Following the merger, P_2's investment in L represents 6 percent of the combined gross assets of P_1 and P_2 (excluding cash and cash items). L was owned 92 percent by Public L and 8 percent by P_1 throughout the testing period ending on the date of the merger.

(ii) *Analysis*. Assuming L can establish that P_2 owns 10 percent or less (by value) of L on May 22, 2013 pursuant to the operating rules of paragraph (j)(15)(iv) of this section, the segregation rules of §1.382–2T(j)(3)(iii) will not apply to segregate P_1's direct public group (Public P_1) immediately before the merger from P_2's direct public group (Public P_2). Thus, following the merger, P_2 is owned 67.5 percent (90% x 75%) by A and 32.5 percent (25% + (10% x 75%)) by Public P_2. Pursuant to paragraph (j)(15)(ii)(B) of this section, Public P_2's lowest percentage of ownership is the sum of its lowest percentage of ownership (zero) and a proportionate amount of former Public P_1's lowest ownership percentage of L of 2.6 percent (32.5% x 8%). P_2 will be treated as having one public group whose ownership interest in L was 2.6 percent before the merger and remains 2.6 percent after the merger. Because Public P_2 owns less than 5 percent of L, Public P_2 is treated as part of Public L. See §1.382–2T(j)(1)(iv). Thus, pursuant to paragraph (j)(15)(ii)(B) of this section, Public L's lowest ownership percentage of L during the testing period is 94.6 percent.

Example 9. Segregation rules inapplicable — prior increase in ownership by former public group during testing period. (i) *Facts*. The facts are the same as *Example 8*, except that P_1 acquired its 8 percent interest in L during the testing period that includes the merger.

(ii) *Analysis*. Pursuant to the rules of paragraph (j)(15)(ii)(A) of this section, the amount of increase in the percentage of stock ownership by Public P_2 is the sum of its increase and any increase by a former public group (Public P_1). Accordingly, Public P_2, the continuing public group, is treated as having increased its ownership interest by 2.6 percent, and Public L is treated as increasing its ownership interest by 2.6 percent.

Example 10. Ownership limitation based upon fair market value. (i) *Facts*. L has two classes of stock outstanding, common stock and preferred stock. The preferred stock is stock within the meaning of §1.382–2(a)(3). A direct public group (Public L) owns all of the common stock of L. P purchased 100 percent of the preferred stock of L at a time when the preferred stock represented 9 percent of the value of all the outstanding stock of L. The common stock owned by Public L represents the remaining 91 percent of the value of the stock of L. P has one class of common stock outstanding, all of which is owned by a direct public group (Public P). On October 7, 2013, P redeems 30 percent of its single outstanding class of common stock. Due to a decline in the relative value of the common stock of L, the preferred stock of L represents 40 percent of the value of all the outstanding stock of L on the date of the redemption.

(ii) *Analysis*. The rules of paragraph (j)(15) of this section do not apply to the redemption because P owns more than 10 percent of L (by value) on that date.

Example 11. Ownership limitation — fair market value includes preferred stock. The facts are the same as in *Example 10*, except that the preferred stock is not stock within the meaning of §1.382–2(a)(3). The results are the same as in *Example 10*.

Example 12. *Ownership limitation — application of attribution rules*. (i) *Facts*. Individual A owns all the outstanding stock of X. A also owns preferred stock in Y that is not stock within the meaning §1.382–2(a)(3), which represents 50 percent of the value of Y. All the Y common stock is owned by public owners. Each of X and Y own 6 percent of the single class of L stock outstanding. On October 6, 2013, Y redeems 15 percent of its common stock.

(ii) *Analysis*. In determining the ownership limitation of this paragraph, the attribution rules of section 318(a) apply. Pursuant to section 318(a)(2), A is treated as owning the L stock owned by X. Pur-

suant to section 318(a)(3), Y is treated as owning the L stock that A indirectly owns. Because Y's ownership of L exceeds the ownership limitation, the rules of paragraph (j)(15) of this section do not apply.

(17) *Effective/applicability date*. This paragraph (j) generally applies to issuances or deemed issuances of stock in taxable years beginning on or after November 4, 1992. However, paragraphs (j)(13) through (j)(15) and Examples 5 through 12 of paragraph (j)(16) apply to testing dates occurring on or after the date these regulations are published as final regulations in the **Federal Register**. See §1.382–3(j)(14)(ii) and (iii), as contained in 26 CFR part 1 revised as of April 1, 1994, for the application of paragraph (j)(10) to stock issued on the exercise of certain options exercised on or after November 4, 1992 and for an election to apply paragraphs (j)(1) through (12) retroactively to certain issuances and deemed issuances of stock occurring in taxable years prior to November 4, 1992.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 22, 2011, 8:45 a.m., and published in the issue of the Federal Register for November 23, 2011, 76 F.R. 72362)

Change to Publication 1220, Specifications for Filing Forms 1097, 1098, 1099, 3921, 3922, 5498, and W–2G, Electronically (Rev. 9–2011)

Announcement 2012–2

This announcement contains an update to Publication 1220, *Specifications for Filing Forms 1097, 1098, 1099, 3921, 3922, 5498, 8935 and W–2G, Electronically, revised (9–2011),* concerning the filing of Form 1099–K.

Part C. Section 6(14), Payee "B" Record Layout for Form 1099–K, field positions 605–608 (page 73), the reference to Rev. Proc. 2004–43 related to Merchant Category Codes has been deleted.

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

Numerical Finding List[1]

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2011–27 through 2011–52 is in Internal Revenue Bulletin 2011–52, dated December 27, 2011.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2011–27 through 2011–52 is in Internal Revenue Bulletin 2011–52, dated December 27, 2011.

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