Internal Revenue
bulletin

Bulletin No. 1997–47
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# HIGHLIGHTS OF THIS ISSUE

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

## INCOME TAX

Rev. Rul. 97–47, page 4.
LIFO; price indexes; department stores. The September 1997 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 1997.

REG–114000–97, page 13.
Proposed regulations under section 1441 of the Code provide guidance regarding the obligation to withhold on interest paid with respect to obligations in the case of the sale of obligations between interest payment dates. A public hearing will be held on January 26, 1998.

Notice 97–64, page 7.
Designation of classes of capital gain dividends by RICs or REITs. This notice describes temporary regulations that will be published permitting RICs and REITs to designate different classes of capital gain dividends in accordance with section 1(h) of the Code as amended by the Taxpayer Relief Act of 1997.

## EXEMPT ORGANIZATIONS

Announcement 97–115, page 17.
Comments are requested from the public on proposals to modify the filing requirements for Form 990, Return of Organization Exempt From Income Tax, and Form 990–EZ, Short Form Return of Organization Exempt From Income Tax.

## ESTATE TAX

Notice 97–63, page 6.
This notice asks for public comment on the alternatives for proposed regulations under section 2056 of the Code in light of the opinion of the Supreme Court of the United States in *Commissioner v. Estate of Hubert.* The proposed regulations would provide guidance on when there is a "material limitation" on the right to income when income is used to pay estate administration expenses.

## EMPLOYMENT TAX

REG–107872–97, page 11.
Proposed regulations under section 1441 of the Code relate to the submission of Form W–8, Certificate of Foreign Status.

## ADMINISTRATIVE

Rev. Proc. 97–53, page 10.
Delete section 355 No Rule. This procedure modifies the "No Rule" revenue procedure, Rev. Proc. 97–3, 1997–1 I.R.B. 85, by deleting section 5.17. The provision concerns certain transactions under section 355(a)(1) of the Code.

Announcement 97–111, page 15.
This announcement describes the method by which taxpayers can enter a new IRS process designed to settle IRS-related disputes that are connected with Bankruptcy Court proceedings in order to reduce Bankruptcy Court litigation.

Finding Lists begin on page 20.

Department of the Treasury
**Internal Revenue Service**

# Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

# Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

# 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 of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

Part IV.—Items of General Interest.
With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

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



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

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

## Section 355.—Distribution of Stock and Securities of a Controlled Corporation

*26 CFR 1.355–2: Limitations.*

The revenue procedure modifies the "No Rule" revenue procedure, Rev. Proc. 97–3, 1997–1 I.R.B. 85, to delete certain transactions under § 355 of the Code. *See* Rev. Proc. 97–53, page 10.

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## Section 472.—Last-in, First-out Inventories

*26 CFR 1.472–1: Last-in, first-out inventories.*

**LIFO; price indexes; department stores.** The September 1997 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 1997.

## Rev. Rul. 97–47

The following Department Store Inventory Price Indexes for September 1997 were issued by the Bureau of Labor Statistics on October 16, 1997. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, September 30, 1997.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, foods, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

| Groups | Sept. 1996 | Sept. 1997 | Percent Change from Sept. 1996 to Sept. 1997[1] |
|---|---|---|---|
| 1. Piece Goods | 534.8 | 521.1 | –2.6 |
| 2. Domestics and Draperie | 644.1 | 646.6 | 0.4 |
| 3. Women's and Children's Shoes | 647.9 | 652.0 | 0.6 |
| 4. Men's Shoes | 916.1 | 902.9 | –1.4 |
| 5. Infants' Wear | 631.9 | 623.3 | –1.4 |
| 6. Women's Underwear | 536.0 | 557.8 | 4.1 |
| 7. Women's Hosiery | 289.0 | 304.3 | 5.3 |
| 8. Women's and Girls' Accessories | 557.1 | 544.1 | –2.3 |
| 9. Women's Outerwear and Girls' Wear | 407.2 | 422.2 | 3.7 |
| 10. Men's Clothing | 612.0 | 620.2 | 1.3 |
| 11. Men's Furnishings | 573.6 | 603.1 | 5.1 |
| 12. Boys' Clothing and Furnishings | 489.8 | 498.7 | 1.8 |
| 13. Jewelry | 1040.3 | 1009.5 | –3.0 |
| 14. Notions | 795.2 | 842.0 | 5.9 |
| 15. Toilet Articles and Drugs | 895.9 | 904.6 | 1.0 |
| 16. Furniture and Bedding | 675.6 | 662.7 | –1.9 |
| 17. Floor Coverings | 589.9 | 583.2 | –1.1 |
| 18. Housewares | 810.0 | 816.8 | 0.8 |
| 19. Major Appliances | 247.1 | 243.4 | –1.5 |
| 20. Radio and Television | 77.2 | 74.9 | –3.0 |
| 21. Recreation and Education[2] | 111.4 | 108.9 | –2.2 |
| 22. Home Improvements[2] | 125.9 | 131.7 | 4.6 |
| 23. Auto Accessories[2] | 107.0 | 108.3 | 1.2 |
| Groups 1 – 15: Soft Goods | 596.8 | 606.4 | 1.6 |
| Groups 16 – 20: Durable Goods | 469.0 | 465.3 | –0.8 |
| Groups 21 – 23: Misc. Goods[2] | 112.6 | 111.8 | –0.7 |
| Store Total[3] | 552.2 | 556.7 | 0.8 |

[1]Absence of a minus sign before percentage change in this column signifies price increase.
[2]Indexes on a January 1986=100 base.
[3]The store total index covers all departments, including some not listed separately, except for the following: candy, foods, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stan Michaels of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Michaels on (202) 622-4970 (not a toll-free call).

## Section 7121.—Closing Agreements

*26 CFR 301.7121–1: Closing agreements.*

What is the method by which taxpayers can enter a new IRS process designed to settle IRS-related disputes that are connected with Bankruptcy Court proceedings in order to reduce Bankruptcy Court litigation? *See* Announcement 97–111, page 15.

## Material Limitation on Surviving Spouse's Right to Income

## Notice 97–63

PURPOSE

This notice invites public comment concerning alternatives for proposed regulations that are being considered in light of the opinion of the Supreme Court of the United States in *Commissioner v. Estate of Hubert*, 520 U.S.__ (1997), 1997–32 I.R.B. 8. The proposed regulations would amend § 20.2056(b)–4(a) of the Estate Tax Regulations by providing guidance regarding when there is a "material limitation" on a surviving spouse's right to the income from property when the income is used to pay estate administration expenses.

BACKGROUND

Under § 2056(a) of the Internal Revenue Code, a marital deduction is allowed to a decedent's estate for property passing from the decedent to the surviving spouse. Under § 2056(b)(5) and (b)(7), a marital deduction is allowed for property passing in trust for the benefit of the spouse if the trust satisfies certain requirements, including the requirement that the spouse be entitled to all of the income for life.

Under § 2056(b)(4)(B), where the interest or property passing to the surviving spouse is encumbered, the encumbrance is taken into account in determining the amount of the allowable marital deduction. Section 20.2056(b)–4(a), which implements § 2056(b)(4)(B), provides that the marital deduction may be taken only for the net value of the interest passing to the surviving spouse. In determining the value of the interest, account must be taken of the effect of any material limitations on the spouse's right to the income from the property. The regulation indicates that this rule may apply in the case of a bequest of property in trust for the benefit of the spouse, when income from the property is used to pay estate administration expenses prior to distribution. The same rule applies in the case of a charitable bequest. Section 20.2055–2(e)(1)(i). However, the regulation provides no definitive guidance on when the use of income would rise to the level of a material limitation.

The facts in *Estate of Hubert* are similar to the following common fact pattern. The decedent's will provides for a residuary bequest to a trust for the benefit of the spouse (the marital trust). This bequest qualifies for the marital deduction. The will provides that estate administration expenses are to be paid from the residuary estate. Further, the will (or state law) permits the executor to use income (otherwise payable to the marital trust) to pay administration expenses, and the executor does so. The issue before the Supreme Court in *Estate of Hubert* was whether, for purposes of § 20.2056(b)–4(a), the executor's use of income to pay estate administration expenses was a material limitation on the surviving spouse's right to the income from the bequest, which would reduce the marital deduction.

The Commissioner argued that the payment of administration expenses from income is, per se, a material limitation on the surviving spouse's right to income for purposes of § 20.2056(b)–4(a), and therefore, the value of any marital bequest should be reduced dollar for dollar by the amount of income used to pay administration expenses. The Court agreed that the value of the marital bequest should be reduced if the use of income to pay administration expenses is a material limitation on the spouse's right to income. The Court found, however, that the regulation does not define material limitation and that the Commissioner had not argued that the use of income in this case was a material limitation. Thus, the Court held for the taxpayer.

In the absence of a regulatory definition of material limitation, the plurality opinion suggested a test for materiality that applies present value principles to date of death estimates of income and expenditures. The concurring opinion suggested two additional tests using date of death estimates of income; one of these tests also applies present value principles.

The number of alternatives that exist to define material limitation, as pointed out by the Court in *Estate of Hubert*, underscores the need to provide guidance regarding when the use of income to pay expenses constitutes a material limitation on a spouse's or charity's right to income. The Internal Revenue Service and the Treasury Department intend to promulgate regulations that provide guidance in this area, and this notice solicits comments on the alternative approaches outlined below.

ALTERNATIVE APPROACHES

One test for materiality under consideration would attempt to distinguish between administration expenses that are properly charged to principal and those that are properly charged to income. Under this test, there would be a material limitation on a surviving spouse's right to income from property if income were used to pay an estate administration expense that is properly charged to principal. Expenses that are properly charged to principal would be those expenses described in § 20.2053–3 as well as other expenses commonly incurred in the administration and settlement of a decedent's estate. Such expenses would include, for example, attorneys' fees, appraisers' fees, brokers' commissions on the sale of property, and estate and inheritance taxes.

Expenses that are properly charged to income (and thus not material limitations on income) would be expenses incurred in the production of income during the period of administration including expenses of collecting and disbursing income and current taxes on income.

The regulation's designation of expenses as properly charged to principal or income would be determinative for purposes of § 20.2056(b)–4(a). Therefore, an expense could be characterized as properly charged to principal even though applicable local law or the governing instrument permitted or directed an executor to charge the expense to income. To the extent that income is used to pay an expense that is properly charged to principal, the payment from income would be treated as having the same effect for purposes of the marital deduction as a payment made from principal. That is, in determining the marital deduction, the value of the property interest passing to the spouse would be reduced by an amount equal to the amount of that administration expense paid from income.

This test for materiality is intended to reflect reasonable estate administration practices and would generally be simple to apply.

Another approach under consideration is a test for materiality that provides for a de minimis safe harbor amount of income that may be used to pay administration expenses without constituting a material limitation on the surviving spouse's right to income. The safe harbor amount could be a cumulative amount determined by a percentage of gross income derived from the property during the period of administration, or a specified dollar amount, or some combination thereof. If more than the safe harbor amount of income were used to pay administration expenses, the marital deduction would be reduced dollar for dollar by the excess over the safe harbor amount of income so used.

The safe harbor approach provides a "bright line" material limitation test. However, if the safe harbor amount were based on the cumulative amount of income derived from the property during administration, the safe harbor amount would have to be recomputed yearly to reflect additional income earned during the year, which might make the test difficult to apply.

An additional approach would be to adopt a regulation stating that any use of income for the payment of administration expenses constitutes a material limitation on the spouse's right to income.

REQUEST FOR COMMENTS

The Service and Treasury invite comments on the tests for materiality described above and also welcome any suggestions for alternative approaches to the issue. In addition, the Service and Treasury are interested in receiving comments on (1) whether the test for materiality under § 20.2056(b)–4(a) should be a quantitative test based on a comparison of the relative size of the income and the expenses charged to income; (2) whether materiality should be determined based on projections as of the date of death rather than on the facts that develop afterwards; and (3) whether present value principles should be applied and, if so, how the practical difficulties of a present value computation can be overcome.

The Service and Treasury are also interested in receiving comments on whether post-death interest accruing on deferred federal estate tax should be treated as properly charged to principal. Rev. Rul. 93–48, 1993–2 C.B. 270, holds that post-death interest accruing on deferred federal estate tax payable from a testamentary transfer does not ordinarily reduce the date of death value of the transfer.

Comments and suggestions are requested by February 4, 1998. An original and eight copies of written comments should be sent to:

Internal Revenue Service
Attn: CC:DOM:CORP:R
Room 5431 (P&SI:Br4)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

or hand delivered between the hours of 8:00 a.m. and 5:00 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:DOM:CORP:R
Room 5431 (P&SI:Br4)
1111 Constitution Ave., NW
Washington, DC

Alternatively, comments may be submitted electronically via the Service's Internet site at:

http://www.irs.ustreas.gov/prod/tax_regs/comments.html

All comments will be available for public inspection and copying in their entirety.

DRAFTING INFORMATION

The principal author of this notice is Deborah Ryan of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Ryan on (202) 622-3090 (not a toll-free call).

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## Temporary Regulations To Be Issued Under Section 1(h) of the Internal Revenue Code (Applying Section 1(h) to Capital Gain Dividends of RICs and REITs).

## Notice 97–64

SECTION 1. PURPOSE

This notice describes temporary regulations that will be issued under § 1(h) of the Internal Revenue Code, effective for taxable years ending on or after May 7, 1997, and provides guidance that regulated investment companies ("RICs"), real estate investment trusts ("REITs"), and their shareholders must use in applying § 1(h) until further guidance is issued.

SEC. 2. BACKGROUND

For individuals, estates, and trusts, § 1(h), as amended by the Taxpayer Relief Act of 1997 (the "1997 Act"), Pub. L. No. 105–34, 111 Stat. 788, imposes differing rates of tax on various transactions giving rise to long-term capital gains or losses. For transactions taken into account during taxable years ending on or after May 7, 1997, a taxpayer's long-term capital gains and losses are separated into three tax rate groups: a 20-percent group, a 25-percent group, and a 28-percent group. *See* Notice 97–59, 1997–45 I.R.B. 7.

The Secretary has authority to issue regulations concerning the application of section 1(h) to long-term gains from sales or exchanges by (or of interests in) passthrough entities, including RICs and REITs.

To the extent that a RIC or a REIT has net capital gain for a taxable year, dividends that it pays during the year (or that it is deemed to pay during the year under § 855, § 858, or § 860) may be designated by it as capital gain dividends. In general, a capital gain dividend is treated by the shareholders as a gain from the sale or exchange of a capital asset held for more than one year.

SEC. 3. BASIC DESIGNATION RULE

Subject to the limitations in section 5, if a RIC or REIT designates a dividend as a capital gain dividend for a taxable year ending on or after May 7, 1997, it may also designate the dividend as a 20% rate gain distribution, an unrecaptured section 1250 gain distribution, or a 28% rate gain distribution. If no additional designation is made regarding a capital gain dividend, it is a 28% rate gain distribution. If a dividend was designated as a capital gain dividend in a written notice mailed to shareholders on or before December 31, 1997, the additional designations permitted by this paragraph may be effected by a written notice, mailed to all shareholders not later than February 2, 1998.

If any capital gain dividend is received on or after May 7, 1997, but is treated

under § 855, § 858, or § 860 as being paid during a taxable year that ends on or before that date, the dividend is a 28% rate gain distribution.

For purposes of this notice, a designation of undistributed capital gains under § 852(b)(3)(D) or § 857(b)(3)(D) is considered to be the designation of a dividend as a capital gain dividend.

## SEC. 4. SHAREHOLDER TREATMENT OF CAPITAL GAIN DIVIDENDS

A capital gain dividend received from a RIC or REIT in a taxable year of the shareholder ending on or after May 7, 1997, is treated as follows:

.01 A 20% rate gain distribution is an amount of long-term capital gain in the 20-percent group;

.02 An unrecaptured section 1250 gain distribution is an amount of long-term capital gain in the 25-percent group; and

.03 A 28% rate gain distribution is an amount of long-term capital gain in the 28-percent group.

## SEC. 5. LIMITATIONS ON DESIGNATIONS OF CAPITAL GAIN DIVIDENDS

Additional designations of capital gain dividends for a taxable year are effective only to the extent that they do not exceed the limitations stated below and only to the extent that they comply with the principles of Rev. Rul. 89–81, 1989–1 C.B. 226, which requires that distributions made to different classes of shares not be composed disproportionately of dividends of a particular type. Designations of capital gain dividends must also comply with § 852(b)(3)(C) or § 857(b)(3)(C) (as appropriate), which make designations ineffective to the extent they exceed the net capital gain for the year.

Subject to a deferral adjustment or bifurcation adjustment discussed in section 6, a RIC or REIT determines the maximum amounts which may be designated in each class of capital gains dividends by performing the computation required by § 1(h) as if the RIC or REIT were an individual whose ordinary income is subject to a marginal tax rate of at least 28 percent. Then, the maximum distributable 20% rate gain is equal to the amount multiplied by 20% in performing that computation and the maximum distributable unrecaptured section 1250 gain is equal to the amount multiplied by 25% in performing that computation. The maximum distributable 28% rate gain is the net capital gain minus the amount of unrecaptured section 1250 gain distributions and 20% rate gain distributions that have been properly designated. For example, if a RIC has net capital gain in the tax year of $100, of which $60 would be multiplied by 20% and $5 would be multiplied by 25% in performing the computations required by § 1(h), then the maximum distributable 20% rate gain is $60 and the maximum unrecaptured section 1250 gain is $5. If the RIC properly designates the maximum permissible unrecaptured section 1250 gain distribution and 20% rate gain distribution, then the RIC's maximum distributable 28% rate gain is $35; *i.e.*, the net capital gain of $100 less the properly designated unrecaptured section 1250 gain distribution of $5 and 20% rate gain distribution of $60.

## SEC. 6. DEFERRAL ADJUSTMENT AND BIFURCATION ADJUSTMENT

The adjustment (a deferral adjustment) required by § 852(b)(3)(C) and § 1.852–11(e) for a RIC with post-October capital losses or by § 857(b)(3)(C) for a fiscal year REIT with post-December capital losses must be made before calculating the limitations on the various classes of capital gain dividends for the RIC's or REIT's taxable year. The deferral adjustment is disregarded in determining the group in which any deferred gain or loss belongs, however, if the group depends on whether an item of gain or loss is taken into account before May 7, 1997, after July 28, 1997, or between those dates. For example, if a RIC's sale of a capital asset held for 19 months occurs before May 7, 1997, but is treated under § 852(b)(3)(C) and § 1.852–11(e) as arising after that date, the sale gives rise to capital gain in the 28-percent group.

A RIC or REIT must make the bifurcation adjustment described in the next paragraph if: (1) its taxable year is not the period used to determine capital gain net income for purposes of the excise tax imposed by § 4982 or § 4981 (that is, it is a RIC with a taxable year that does not end on October 31 and that has not made an election under § 4982(e)(4) or it is a REIT whose taxable year is not the calendar year); (2) it has a net capital gain during the pre-November (for a RIC) or pre-January (for a REIT) portion of its taxable year; and (3) it is not required to make the deferral adjustment.

If a RIC or REIT is required to make a bifurcation adjustment, it must calculate the maximum distributable 20% rate gain and the maximum distributable unrecaptured section 1250 gain separately for the pre-November (pre-January for REITs) portion of the year and for the post-October (post-December for REITs) portion of the year, as if the two portions of the year were separate taxable years. Then, the maximum distributable 20% rate gain and the maximum distributable unrecaptured section 1250 gain for the taxable year equals the sum of the maximum distributable amounts for gains in that group determined for each portion of the year.

## SEC. 7. EXAMPLES

(1) Example 1. RIC *X*'s taxable year ends on July 31. RIC *X* has only the following capital gains and losses for the periods indicated:

| 8/1 to 10/31/97 | gain | loss | net |
|---|---|---|---|
| Long-term capital gain or loss | | | |
| stock held 19 months | 300 | (150) | 150 |
| stock held 13 months | 200 | (100) | 100 |
| Short-term capital gain or loss | 100 | 0 | 100 |
| 11/1 to 7/31/98 | | | |
| Long-term capital gain or loss | | | |
| stock held 19 months | 200 | (50) | 150 |
| stock held 13 months | 200 | (300) | (100) |
| Short-term capital gain or loss | 0 | (100) | (100) |

Because *X* has a taxable year ending in July and a post-October net capital loss of $50, it is required by § 852(b)(3)(C) and § 1.852-11(e) to make a deferral adjustment and so does not make a bifurcation adjustment. *X* must disregard the capital gains and losses for the post-October period in computing its net capital gains for purposes of designating capital gain dividends for its taxable year ending July 31, 1998. *X* must also disregard those gains and losses for purposes of calculating the various maximum distributable amounts of gain. For this taxable year, therefore, *X* may designate up to $250 as capital gain dividends, of which up to $150 may be designated as 20% rate gain distributions. The amount that may be designated as 28% rate gain distributions (or is a 28% rate gain distribution if designated only as a capital gain dividend) is $250 minus any amounts properly designated as 20% rate gain distributions. *X* must take the post-October capital gains and losses into account on August 1, 1998 (the first day of the next taxable year), to determine its net capital gain and various maximum distributable amounts of gain for the taxable year beginning on that date.

(2) Example 2. RIC *Y*'s taxable year ends on July 31. RIC *Y* has only the following capital gains and losses for the periods indicated:

| 8/1 to 10/31/97 | gain | loss | net |
|---|---|---|---|
| Long-term capital gain or loss | | | |
| stock held 19 months | 300 | (150) | 150 |
| stock held 13 months | 200 | (100) | 100 |
| Short-term capital gain or loss | 100 | 0 | 100 |
| 11/1/97 to 7/31/98 | | | |
| Long-term capital gain or loss | | | |
| stock held 19 months | 200 | (50) | 150 |
| stock held 13 months | 200 | (300) | (100) |
| Short-term capital gain or loss | 0 | 0 | 0 |

Because *Y* does not have a post-October capital loss for its taxable year ending July 31, 1998, it does not make a deferral adjustment. Because *Y* has a taxable year ending in July and a pre-November net capital gain, it must make a bifurcation adjustment. *Y* must determine the maximum distributable amounts of 20% rate gain and unrecaptured section 1250 gain separately for the pre-November and the post-October portion of its taxable year ending July 31, 1998. The sum of these amounts determines the various maximum distributable amounts of gain for the entire taxable year. For the pre-November period, *Y*'s maximum distributable 20% rate gain is $150. For the post-October portion of the year, *Y*'s maximum distributable 20% rate gain is $50. *Y*'s net capital gain for the entire year is $300. For this taxable year, therefore, *Y* may designate up to $300 of capital gain dividends, of which up to $200 may be designated as 20% rate gain distributions. The amount that may be designated as 28% rate gain distributions (or that will be deemed a 28% rate gain distribution if designated only as a capital gain dividend) is $300 minus any amounts properly designated as 20% rate gain distributions.

SEC. 8. SECTION 1202 GAIN

In the future, RICs may recognize gain from the sale or exchange of qualified small business stock held for more than 5 years that may be distributed to shareholders subject to certain limitations provided by § 1202(g). It is expected that the temporary regulations will provide guidance on how RICs may designate dividends as "section 1202 gain distributions." This guidance is expected to provide that: (1) section 1202 gain distributions will be designated separately for different issuers of qualified small business stock; (2) the exclusion from income permitted by § 1202 will be determined at the shareholder level not the RIC level; and (3) the maximum distributable section 1202 gain for each issuer will be calculated separately from limitations on all other classes of capital gain dividends but in the aggregate will not exceed the RIC's net capital gain.

SEC. 9. USE OF SUBSTITUTE FORMS 1099–DIV FOR 1997

The rules set forth in this section and in section 10 previously have been published in Announcement 97–109, 1997–45 I.R.B. 12.

RICs, REITs, brokers, and others reporting capital gain distributions on the 1997 Form 1099–DIV must provide additional information with their statements to recipients. Payers must continue to report the total capital gain distributions in box 1c. Payers should also advise recipients that they cannot report capital gain distributions on Form 1040, line 13, as stated in the official 1997 Form 1099–DIV. Rather, they must report the distributions on Schedule D (Form 1040), line 13, column (f).

In addition, payers must provide to recipients information sufficient to determine the following:

.01 The amount of 28% rate gain distributions. Payers should advise recipients to report this amount on Schedule D (Form 1040), line 13, column (g).

.02 The amount of unrecaptured section 1250 gain distributions. Payers should advise recipients to report this amount on Schedule D (Form 1040), line 25.

Payers may provide this additional information to recipients on a substitute statement or on a separate statement. Payers are not required to report the additional information to the IRS.

SEC. 10 USE OF SUBSTITUTE FORMS 2439 FOR 1996–1997

RICs and other filers completing the 1996 Form 2439 for fiscal years ending after May 6, 1997, must provide additional information with their notices to shareholders. Filers must continue to report the total undistributed long-term capital gains for the year on line 1 of Form 2439. Filers should also advise individual shareholders that they cannot report the amount on line 1 on Schedule D (Form 1040), Part II, line 12, as stated in the official 1996 Form 2439 instructions. Rather, they must report the amount on line 1 on the 1997 Schedule D (Form 1040), line 11, Column (f).

In addition, filers must provide to shareholders information sufficient to determine the following:

.01 The amount of 28% rate gain included on line 1 of Form 2439. Filers should advise recipients to report this amount on Schedule D (Form 1040), line 11, column (g).

.02 The amount of unrecaptured section 1250 gain included on line 1 of Form 2439. Filers should advise recipients to report this amount on Schedule D (Form 1040), line 25.

Filers may provide this additional information to shareholders on a substitute statement or on a separate statement. Filers are not required to report this additional information on Forms 2439 filed with the IRS.

SEC. 11. SUBMISSION OF COMMENTS

Comment are requested on the subject matter of this notice and, additionally, on the proper treatment of a loss on the sale of a RIC or REIT share held for six months or less that is recharacterized under § 852(b)(4)(A) or § 857(b)(7) as a long-term capital loss. Taxpayers may submit comments to: CC:DOM:CORP:R (OGI–117972–97), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20022. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (OGI–117972–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/ tax_regs/comments.html. Comments will be available for public inspection.

SEC. 12 PAPERWORK REDUCTION ACT

The collections of information contained in this notice 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 1545–1565.

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 notice are in sections 3, 9 and 10. This information is required to permit RIC and REIT shareholders to properly report income following the amendment of § 1(h) by the 1997 Act. The information collected will be used by RIC and REIT shareholders reporting income. The collection of information is mandatory. The likely respondents are businesses and other for-profit institutions.

The burden for the collections of information in section 3 is as follows:

The estimated total annual reporting and/or recordkeeping burden is 1500 hours.

The estimated annual burden per respondent varies from 1/4 hour to 10 hours, depending on individual circumstances, with an estimated average of 1/2 hour. The estimated number of respondents is 3,000.

The estimated annual frequency of responses is annually.

The burden for the collection of information in sections 9 and 10 is reflected in the burden for Form 1099–DIV and Form 2439.

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

DRAFTING INFORMATION

The principal author of this notice is Kenneth Christman of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this notice contact Kenneth Christman on (202) 622-3950 (not a toll-free call).

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*26 CFR 601.201: Rulings and determination letters.*
*(Also Part I, §§ 355; 1.355–2.)*

## Rev. Proc. 97–53

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 97–3, 1997–1 I.R.B. 85, (January 6, 1997), which sets forth provisions of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Domestic) and the Associate Chief Counsel (Employee Benefits and Exempt Organizations) relating to matters where the Service will not issue advance rulings or determination letters.

SECTION 2. BACKGROUND

Section 5 of Rev. Proc. 97–3 lists areas under extensive study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations, or otherwise. Section 5.17 of Rev. Proc. 97–3 provides that rulings or determination letters will not be issued under § 355(a)(1) of the Code with respect to certain distributions until the Service resolves issues related to these distributions. The no rule position of section 5.17 was originally set forth in Rev. Proc. 96–39, 1996–2 C.B. 300, which was superseded by Rev. Proc. 97–3.

SECTION 3. PROCEDURE

Rev. Proc. 97–3 is modified by deleting section 5.17.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective on November 10, 1997, the date it is made available to the public.

DRAFTING INFORMATION

The principal author of this revenue procedure is Dean P. Lekos of the Office of Assistant Chief Counsel (Corporate). For further information regarding this revenue procedure, contact Mr. Lekos on (202) 622-7550 (not a toll-free call).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking

## Electronic Transmission of Form W–8

## REG–107872–97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the submission of Form W–8, a withholding certificate, needed for purposes of chapters 3 and 61 of the Internal Revenue Code (Code) and other withholding or reporting provisions of the Code, such as section 3402, 3405, or 3406. The proposed regulations provide guidance to withholding agents and payors who wish to establish an electronic system for use by beneficial owners or payees in furnishing Form W–8. The proposed regulations state the general requirements that such an electronic system must satisfy so that a withholding agent or payor may rely on a Form W–8 transmitted through such a system. These regulations affect withholding agents and payors that establish electronic systems and beneficial owners and payees who use these systems.

DATES: Written comments and requests for a public hearing must be received by January 12, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–107872–97), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–107872–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Lilo Hester, 202-622-3840; concerning submissions, Evangelista Lee, 202-622-8452 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

*Background*

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 1441 of the Internal Revenue Code (Code). These amendments are proposed to provide general procedures for withholding agents and payors to establish acceptable electronic systems.

T.D. 8734, 1997–44 I.R.B. 5 adds §1.1441–1(e)(4)(iv) which authorizes the electronic transmission of a Form W–8 described in §1.1441–1(e)(1)(i). In addition, by cross-reference contained in §1.6049–5(c)(2) (published as a final rule in T.D. 8734), the regulation authorizes electronic transmission of a Form W–8 furnished for purposes of chapter 61 of the Code (i.e., information reporting) or for purposes of another income tax withholding provision of the Code, such as section 3406.

Pursuant to chapter 3 (or, in certain cases, chapter 61) of the Code, a beneficial owner or a payee (i.e., a person who receives a payment) must furnish a withholding certificate to a withholding agent or payor in order to establish its status as a foreign person and entitlement to a reduced rate of withholding. By establishing foreign status, and other relevant characteristics, a beneficial owner or payee may be entitled to a reduction or exemption in the amount of withholding under chapter 3 of the Code or an exemption from information reporting under chapter 61 of the Code or from backup withholding under section 3406. The receipt of a withholding certificate affects the amount of tax that the withholding agent or payor may be required to withhold from the payment, and the type and form of information that it must provide to the IRS. The regulations under sections 1441 and 1443 specifically identify Form W–8 (or an acceptable substitute form) as the required form of the withholding certificate.

These proposed regulations apply to electronic transmission of Forms W–8. The regulations do not apply to Form 8233 for use by individuals who claim a reduced rate of withholding under an income tax convention for services performed in the United States. See §1.1441–4(b)(2). In addition, the regulations do not apply to documentary evidence (described in §1.6049–5(c)(1)) that may be substituted for the Form W–8 with respect to certain payments made to accounts maintained outside of the United States. However, the IRS and Treasury invite comments on any computer technology (e.g., imaging) that could make electronic transmission of documentary evidence possible.

*Explanation of Provisions*

1. *Type and Design of System Determined by Withholding Agent or Payor Subject to Specific Requirements.*

Under the proposed regulations, a withholding agent or payor may choose to establish an electronic system to receive or transmit Forms W–8 (or such other form as the IRS may prescribe), including a payor or withholding agent that is an intermediary. The withholding agent or payor may determine the type of system (such as telephone or computer) available for that purpose. The system must, however, (1) reliably identify the user, (2) ensure that the information received is the information sent, and (3) document occasions of user access that result in a submission, renewal, or modification of the withholding certificate. The proposed regulations envision that implementation of these specific requirements necessitates a direct relationship between the withholding agent or payor and the beneficial owner or payee. The proposed regulations reserve on applicable standards for systems used by intermediaries to transmit forms received from another payor or withholding agent. The IRS and Treasury recognize the importance of allowing the electronic transmission of Forms W–8 through one or more intermediaries (i.e., persons not acting for their own account). Therefore, comments are solicited regarding the logistical operation of an electronic transmission system for use by an intermediary satisfying the IRS requirements that the integrity, accuracy,

and reliability of the original electronic transmission through an intermediary system is adequately protected.

2. *Relationship Between Paper and Electronic Withholding Certificate.*

The electronic transmission must contain exactly the same information as the paper Form W–8 (or such other form as the IRS may prescribe). Any guidance, such as regulations or instructions, that applies to the paper Form W–8 also applies to electronically transmitted forms.

3. *Electronic Filing Optional.*

Section 1.1441–1(e)(4)(iv) authorizing the use of electronic systems was promulgated to assist in reducing burdens (in terms of cost and time) on withholding agents, payors, payees, and beneficial owners. The use of an electronic system for the transmission of Form W–8 is merely an alternative to the use of a paper form. Electronic transmission of Form W–8 is not mandatory. A withholding agent or payor may not mandate the use of electronic systems to receive or transmit the forms. Thus, a payee or beneficial owner may furnish a Form W–8 to the withholding agent or payor on paper.

4. *Signature Under Penalties of Perjury.*

Section 6061 generally provides that any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall be signed in accordance with forms or regulations prescribed by the Secretary. Section 301.6061–1(b) provides that the Secretary may prescribe in forms, instructions, or other appropriate guidance the method of signing any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations. Section 6065 provides that, except as provided by the Secretary, any return, statement or other document shall contain or be verified by a written declaration that it is made under the penalties of perjury. These requirements apply to a Form W–8 (or such other form as the Internal Revenue Service may prescribe), including one that is filed electronically, as provided in §1.1441–1(e)-(2)(ii), (3)(ii), (3)(iii), and (3)(v), and §1.1441– 5(c)(2)(iv) and (3)(iii) of the final regulations. The proposed regulations, therefore, include guidance on the perjury statement and the signature requirements for Forms W–8 that are filed electronically.

5. *IRS Requests for Electronic Data.*

Upon request by the IRS in the course of an examination, a withholding agent or payor must supply a hard copy of the information contained on the electronically transmitted Form W–8 and a statement that, to the best of the withholding agent's knowledge, the electronic Form W–8 was furnished by the person whose name is on the form. The printout of the Form W–8 information must be provided to the IRS in English.

*Proposed Effective Date*

These regulations are proposed to become effective January 1, 1999.

*Special Analyses*

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

*Comments and Requests for a Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight copies) that are submitted timely (in the manner described in the ADDRESSES portion of this preamble) to the IRS. All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by any person that submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

*Drafting Information*

The principal author of these regulations is Lilo A. Hester, Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and 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 * * *

Par. 2. In §1.1441–1, paragraph (e)(4)(iv) is revised to read as follows:

*§1.1441–1 Requirement for the deduction and withholding of tax on payments to foreign persons.*

* * * * *

(e) * * *

(4) * * *

(iv) *Electronic transmission of information*—(A) *In general.* A withholding agent may establish a system for beneficial owners or payees to furnish electronically Forms W–8 (or such other form as the Internal Revenue Service may prescribe). The system also may enable the withholding agent to electronically transmit Forms W–8 to another person. The system must meet the requirements described in paragraph (e)(4)(iv)(B) of this section.

(B) *Requirements*—(1) *In general.* The electronic system must ensure that the information received is the information sent, and must document all occasions of user access that result in the submission, renewal, or modification of a Form W–8. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and furnishing Form W–8 is the person named in the form.

(2) *Same information as paper Form W–8.* The electronic transmission must provide the withholding agent or payor with exactly the same information as the paper Form W–8.

(3) *Perjury statement and signature requirements.* The electronic transmission

must be signed by way of an electronic signature by the person whose name is on the Form W–8 and the signature must be under penalties of perjury in the manner described in this paragraph (e)(4)(iv)(B)(3).

(i) *Perjury statement.* The perjury statement must contain the language that appears on the paper Form W–8. The electronic system must inform the person whose name is on the Form W–8 that the person must make the declaration contained in the perjury statement and that the declaration is made by signing the Form W–8. The instructions and the language of the perjury statement must immediately follow the person's certifying statements and immediately precede the person's electronic signature.

(ii) *Electronic signature.* The act of the electronic signature must be effected by the person whose name is on the electronic Form W–8. The signature must also authenticate and verify the submission. For this purpose, the terms *authenticate* and *verify* have the same meanings as they do when applied to a written signature on a paper Form W–8. An electronic signature can be in any form that satisfies the foregoing requirements. The electronic signature must be the final entry in the person's Form W–8 submission.

(4) *Requests for electronic Forms W–8 data.* Upon request by the Internal Revenue Service during an examination, the withholding agent must supply a hard copy of the electronic Form W–8 and a statement that, to the best of the withholding agent's knowledge, the electronic Form W–8 was filed by the person whose name is on the form. The hard copy of the electronic Form W–8 must provide exactly the same information as, but need not be a facsimile of, the paper Form W–8.

(C) *Special requirements for transmission of Forms W–8 by an intermediary.* [Reserved].

* * * * *

Michael P. Dolan,
*Acting Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on October 6, 1997, 8:45 a.m., and published in the issue of the Federal Register for October 14, 1997, 62 F.R. 53504)

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## Notice of Proposed Rulemaking and Notice of Public Hearing

## Withholding on Interest in the Case of Sales of Obligations Between Interest Payment Dates

## REG–114000–97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This notice of proposed rulemaking provides guidance regarding the obligation to withhold on interest paid with respect to obligations in the case of the sale of obligations between interest payment dates. These regulations would affect United States and foreign withholding agents and recipients. This document also provides notice of a public hearing on these proposed regulations.

DATES: Comments and outlines of oral comments to be presented at the public hearing scheduled for January 26, 1998, at 10 a.m. must be received by January 5, 1998.

ADDRESSES: Send submission to: CC:DOM:CORP:R (REG–114000–97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20224. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (Reg–114000–97), Courier desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.ustreas.gov/ prod/tax_regs/comments.html. The hearing scheduled for January 26, 1998, will be held in the Commissioner's Conference Room, room 3313, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Lilo Hester at (202) 622-3840 (not a toll-free number); concerning submissions and the hearing, Evangelista Lee, (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION

*Background*

In T.D. 8734, 1997–44 I.R.B. 5, the IRS and Treasury published final withholding and reporting regulations under chapter 3 of the Internal Revenue Code (Code) and other sections of the Code. Section 1.1441–3(b)(2) of the final regulations provides that no withholding is required upon interest accrued on the date of a sale of debt obligations when the sale occurs between two interest payment dates, even though the amount is treated as interest under §1.61–7(c) or (d) and is subject to tax under section 871 or 881. In contrast, §1.1441–2(b)(3) of the final regulations provides that withholding is required on amounts of original issue discount in the event of a sale of an original issue discount obligation or a payment on such an obligation, subject to certain exceptions. The IRS and Treasury believe that, in view of these provisions, the exemption from withholding on non-OID amounts is no longer justified. A withholding agent that pays amounts to a foreign person in connection with the sale of an obligation between interest payments dates is in the same position as a withholding agent that pays amounts to a foreign person in connection with the sale of an original issue discount obligation. The withholding exemption for sale of debt obligations between interest payment dates provides an easy avenue for the avoidance of the documentation requirements imposed under sections 871(h) and 881(c) for purposes of qualifying interest on registered debt obligations as portfolio interest. For this reason, and in order to create parity with the tax treatment of original issue discount obligations under chapter 3 of the Code, it is no longer appropriate to continue this exemption.

Under §1.1441–2(b)(3), a withholding agent must withhold on an amount of original issue discount to the extent that it has actual knowledge of the proportion of the amount of the payment that is taxable to the beneficial owner under section 871(a)(1)(C) or 881(a)(3)(A). A withholding agent has actual knowledge if it knows how long the beneficial owner has held the obligation, the terms of the obligation, and the extent to which the benefi-

cial owner purchased the obligation at a premium. A withholding agent is treated as having knowledge if the information is reasonably available. Special rules are provided for withholding agents with which the beneficial owner does not maintain a direct account relationship. Further, the regulations under §1.1441–2(b)(3) dealing with original issue discount provide that, in the case of an obligation that would qualify as portfolio interest if documentation were provided to the withholding agent, withholding is required on the entire amount of stated interest, if any, and original issue discount, if no such documentation is provided, irrespective of whether the withholding agent has knowledge of the portion of the payment representing taxable original issue discount. For this purpose, the withholding agent may rely upon the IRS "List of Original issue Discount Instruments" contained in IRS Publication 1212 (available from the IRS Distribution Centers).

In response to comments, the provisions in §1.1441–3(b)(1) are proposed to be modified to reduce the amount upon which withholding is required. No obligation to withhold is imposed under current law on the payment of stated interest on an obligation that was purchased between interest payment dates. Under §1.61–7(c), interest received on the interest payment date is treated as a return of basis to the extent it represents accrued unpaid interest as of the date of purchase as reflected in the new holder's basis for the obligation. Therefore, when the new holder receives a payment of the stated interest, the holder's tax liability is limited to the amount of interest accrued after the date of purchase (subject to additional adjustments reflecting possible acquisition premiums or market discounts). Because of the difficulty for a withholding agent to determine the amount accrued to the holder and other adjustments affecting the actual amount taxable to the holder, withholding on the entire amount of stated interest is required under the current withholding regulations under §1.1441–3(b)(1).

Commentators have asked that the withholding agent be permitted to withhold on the amount that it knows is taxable. The final withholding regulations did not modify the proposed regulations on this point because the Treasury and IRS consider that withholding on the entire amount is justified if withholding on ` sales of obligations between interest payment dates is not required. However, because these proposed regulations require withholding, the regulations permit a withholding agent to adjust the amount of withholding at the time of payment of stated interest to account for earlier withholding.

*Special Analyses*

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

*Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 26, 1998, at 10 a.m. in the Commissioner's Conference Room, room 3313, Internal Revenue Building, 1111 Constitution Ave, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit comments and an outline of the topics to be discussed and the time to be devoted to each topic by January 5, 1998.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

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*Proposed Amendments to the Regulations*

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

PART 1—INCOME TAXES

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

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

Par. 2. In §1.1441–3, paragraph (b) is revised to read as follows:

*§1.1441–3 Determination of amount to be withheld*

* * * * *

(b) *Withholding on payments on certain obligations*—(1) *Withholding at time of payment of interest.* When making a payment on an interest-bearing obligation, a withholding agent must withhold under §1.1441–1 upon the gross amount of stated interest payable on the interest payment date, regardless of whether the payment constitutes a return of capital or the payment of income within the meaning of section 61, unless the withholding agent has knowledge of the actual amount of interest paid. For this purpose, the withholding agent may rely on information provided by the issuer (or its paying agent), on a representation from the beneficial owner, or on information that the withholding agent has in its records. To the extent an amount was withheld on an amount of capital rather than interest, see rules for adjustments, refunds, or credits under §1.1441–1(b)(8).

(2) *No withholding between interest payment dates*—(i) *General rule.* A withholding agent is not required to withhold under §1.1441–1 upon interest accrued on the date of a sale of debt obligations when that sale occurs between two interest payment dates (even though the amount is treated as interest under §1.61–7(c) or (d) and is subject to tax under section 871(a) or 881(a)), unless the withholding agent has knowledge of the amount paid as interest. For purposes of this paragraph (b)(2)(i), a withholding agent is treated as having knowledge in the same manner as a withholding agent has knowledge for

purposes of §1.1441–2(b)(3)(ii), dealing with withholding on original issue discount. In addition, notwithstanding lack of knowledge (within the meaning of §1.1441–2(b)(3)(ii)), withholding is required on the entire amount of stated interest paid with respect to the obligation as determined as of the date of original issue if the withholding agent, pursuant to the provisions in §1.1441–1(b)(3), treats the payment as made to a foreign payee because it cannot associate the payment with required documentation and the amount would qualify as portfolio interest. See §1.1441–1(b)(8) for adjustments to any amount that has been overwithheld as a result of this provision.

(ii) *Applicable rules.* Any exemption from withholding pursuant to paragraph (b)(2)(i) of this section applies without a requirement that documentation be furnished to the withholding agent. However, documentation may have to be furnished for purposes of the information reporting provisions under section 6049 and backup withholding under section 3406. See §1.6045–1(c) for reporting requirements by brokers with respect to sale proceeds. Any exemption from withholding under paragraph (b)(2)(i) of this section is not a determination that the accrued interest is not fixed or determinable annual or periodical income. See §1.61–7(c) regarding the character of payments received by the acquirer of an obligation subsequent to such acquisition (that is, as a return of capital or interest accrued after the acquisition).

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Michael P. Dolan,
*Acting Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on October 6, 1997, 8:45 a.m., and published in the issue of the Federal Register for October 14, 1997, 62 F.R. 53503)

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## Test of Bankruptcy Appeals Process

## Announcement 97–111

**TABLE OF CONTENTS**



### SECTION 1. SUMMARY

This Announcement describes a process for quickly resolving certain IRS-related disputes connected with a taxpayer's Bankruptcy Case. This administrative process does not alter existing Bankruptcy Court jurisdiction or procedures. With this process, the IRS offers an administrative method to eliminate litigation by resolving IRS-related bankruptcy disputes that are raised by debtors (or debtors' estates) against the Service in Bankruptcy Court. Debtors can be individuals, corporations, trusts, or partnerships. This process combines two Internal Revenue Service functions to review these disputes: the Office of Special Procedures within the Collection Division, and the Office of Appeals. The process in this announcement is effective during the six month to one-year test period beginning on November 6, 1997, the date this announcement is released to the public. The test will be conducted in four Internal Revenue Service Districts: Houston, Indiana, New England (Massachusetts Bankruptcy courts only), and Southwest (Arizona Bankruptcy Courts only).

### SECTION 2. PURPOSE AND SCOPE

#### .01 Purpose

This process is being tested as a response to the growing volume of bankruptcy cases nationwide. It is intended to alleviate Service-related litigation in U.S. Bankruptcy Courts (established under Title 28 U.S.C. § 151) and to provide debtors with a fast and effective means to resolve their disputes. These procedures provide for a thorough review of the debtor's dispute with the Service and offer an expedited appeal of any adverse determination. Service representatives will have substantial authority to settle disputes under these procedures as well as the authority to make all appropriate changes to taxpayer accounts. If a bankruptcy dispute is also eligible for the Collection Appeals Program (CAP – see IRS Publication 1660), taxpayers are requested to use this bankruptcy process instead because it is specifically designed to resolve bankruptcy disputes.

#### .02 Disputes Eligible for Consideration Under the Bankruptcy Procedures

The following issues may be considered under the Bankruptcy Appeals Process:

- Dischargeability determinations
  –other than when the Service asserts lack of dischargeability under B.C. § 523 (a)(1)(C) for willful evasion of taxes
- Proof of Claim and administrative claim issues
- Automatic stay violation issues
- Setoff and refund issues
- Preferences

This process is designed to resolve disputes between the Service and a debtor or a debtor's estate at the earliest possible date after the debtor has commenced the bankruptcy proceeding. Only the debtor or the debtor's estate may seek resolution of the issue with the Service by following the procedures set forth in this announcement. The Bankruptcy Appeals Process is not available to third parties, such as competing creditors, creditors' committees, responsible persons of the debtor, or other interested parties because of potential disclosure of taxpayer information that is protected by I.R.C. § 6103. These third parties can address their concerns, including those regarding any settlement between the debtor or the debtor's estate and the Service, through existing Bankruptcy Court procedures.

**.03 The Bankruptcy Appeals Process**

Disputes will be reviewed initially by the Office of Special Procedures within the Collection Division (SPf). SPf will evaluate the merits of the debtor's position and make a determination of the IRS's position. If this decision is adverse to the debtor, SPf will review the determination at the debtor's request. If the final decision of SPf is adverse to the debtor, the debtor may appeal the decision to the Office of Appeals. The Office of Appeals will then review the matter and make an independent decision. Where appropriate, Appeals may offer a settlement in order to avoid litigation. During processing of the dispute, the debtor will have an opportunity to confer with IRS representatives. However, due to the volume of bankruptcy disputes, it is anticipated that all conferences will be conducted over the telephone. The processing for disputes should be about 15 days if no appeal is needed, and will generally be 30 days if an appeal is requested.

**SECTION 3. ENTERING THE PROCESS**

**.01 Requirements to Enter the Bankruptcy Appeals Process**

In order to enter the Bankruptcy Appeals Process, a debtor must have filed a petition in Bankruptcy Court in one of the test districts and the bankruptcy case must be open at the time this Process is initiated (except in limited circumstances where the bankruptcy case has been closed out but the debtor believes that Service actions are inconsistent with Bankruptcy Court orders). A debtor may begin the process even though the debtor has begun contesting the dispute in Bankruptcy Court by filing an adversary proceeding or objecting to the Service's proof of claim. If the issue has already been litigated before the Bankruptcy Court, however, the Bankruptcy Appeals Process is not available. SPf will advise the debtor whether the debtor may begin the Bankruptcy Appeals Process or must wait until other Service functions complete their work.

**.02 Contacting the IRS for Information or Entry into the Bankruptcy Appeals Process**

Information about the Bankruptcy Appeals Process will be provided by the Office of Appeals. The Appeals site on the World Wide Web contains a reprint of this Announcement and may contain other useful information. The address is:

http://www.irs.ustreas.gov/prod/ind_info/appeals/index.html

Appeals can also be contacted directly at each test site with inquiries about this Process. The Appeals office phone and FAX numbers are:

Boston: (617) 565-7900
FAX: (617) 565-8775

Houston: (281) 721-7241
FAX: (281) 721-7220

Indianapolis: (317) 226-6540
FAX: (317) 226-5340

Phoenix: (602) 207-8114
FAX: (602) 207-8116

To enter this Process, a debtor must generally contact, either in writing or by telephone, the Office of Special Procedures in the test district where the debtor filed the bankruptcy petition. These Special Procedures offices will not be able to provide general information about the Bankruptcy Appeals Process. They will only assist with entering the Process and will only provide information that directly relates to entering the Process. The offices are:

Houston District:
IRS Insolvency
ATTN: ADR
1919 Smith
Stop 5020 HOU
Houston, TX 77002
Telephone: (713) 209-3883

Indiana District:
IRS Insolvency
ATTN: ADR
P.O. Box 44211, Stop 41
Indianapolis, IN 46244
Telephone: (317) 226-6273

New England District
(Massachusetts Bankruptcy Courts):
IRS Insolvency
ATTN: ADR
PO Box 9112
Stop 20800
John F. Kennedy Building
Boston, MA 02203
Telephone: (617) 565-1589

Southwest District
(Arizona Bankruptcy Courts):
IRS Insolvency
ATTN: ADR
210 E. Earll Drive
Stop 5012
Phoenix, Arizona 85012
Telephone: (602) 207-8546

**.03 Required Documentation**

Debtors must provide copies of their Bankruptcy Court documents to begin the Bankruptcy Appeals Process. Income tax returns that have not been filed and are past due must be filed before the Bankruptcy Appeals Process can consider the dispute, if evaluation of the dispute requires their review. The returns may be filed with SPf. The debtor must also present any other documents or information pertinent to the Service's review of the dispute upon beginning the Bankruptcy Appeals Process. Within two workdays of meeting all documentation requirements, SPf will begin its review of the dispute.

**SECTION 4. PROCESSING A BANKRUPTCY DISPUTE**

**.01 SPf Procedures**

SPf will complete its initial review within ten workdays. Additional time will be provided, when necessary, if SPf must request documents from within the Service (such as a return) or ask the debtor to provide additional documentation. The IRS may cease processing the debtor's dispute if the debtor fails to provide necessary documentation. If the IRS ceases case processing because the debtor failed to provide necessary documentation, the debtor may begin the Process again as described under Section 3.02 if the debtor submits the necessary documentation.

If SPf agrees with the debtor's position on the dispute, SPf will determine what actions are necessary to correct the matter and will commence these actions immediately and complete them within 30 workdays. If SPf disagrees with the debtor, SPf will contact the debtor and inform the debtor of SPf's determination. At this time, the debtor will be offered the right to request that SPf review its decision. If the debtor requests it, this review will be completed within five workdays. If, after reviewing its decision, SPf agrees with the debtor, any actions to correct the matter will be commenced immediately and will be completed within 30 workdays.

If the second review by SPf does not support the debtor, SPf will immediately advise the debtor by letter. The letter will include an appeal request form which the debtor must complete and mail back to SPf within 10 workdays in order to obtain an appeal. If the request is timely mailed, the case will be forwarded to Appeals.

**.02 Appeals Procedures**

In order for a dispute to reach Appeals under the Bankruptcy Appeals Process, the dispute must have received a second review by SPf under the Bankruptcy Appeals Process (as described in Section 4.01). The second review by SPf must have reached a determination that is adverse to the debtor's interest, and the debtor must have requested Appeals' consideration.

Case processing times by Appeals will be as follows (except as extended by agreement):

• For dischargeability determinations, within 45 workdays of receipt in Appeals

• For all other issues specified in Section 2.02, within 10 workdays of receipt in Appeals.

After reaching a decision, Appeals will send a letter to the debtor describing the decision. The letter will state whether or not Appeals agrees with the debtor's position and will describe any actions that will be taken to correct the matter. Any corrective actions will be commenced by SPf within three workdays after Appeals reaches a decision and will be completed within 30 workdays. In the event of a decision that is adverse to the debtor, no further administrative recourse is available to the debtor through the IRS.

**SECTION 5. NO USER FEE**

There is no user fee for this Process.

**SECTION 6. EFFECTIVE DATE**

These procedures are effective for disputes of which SPf is notified during the six months to one-year test period beginning on November 6, 1997, the date this announcement is released to the public. At the end of the test period, the Service will evaluate the Process and determine whether to extend the test or to adopt the Process on a nationwide basis, and whether the Process may consider additional issues.

**DRAFTING INFORMATION**

The principal author of this announcement is Gary Slayen, analyst for the Office of Field Services, National Office Appeals. For further information regarding this announcement, please contact Mr. Slayen at (202) 401-6155 (not a toll-free number).

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## Request for Public Comments on Proposals to Modify Filing Requirements for Exempt Organizations Forms 990 and 990–EZ

### Announcement 97–115

The Internal Revenue Service invites comments from interested members of the public on proposals it is considering to modify the requirements for filing Form 990, *Return of Organization Exempt From Income Tax,* and Form 990–EZ, *Short Form Return of Organization Exempt From Income Tax.* The comments will be considered before final decisions on the proposals are made.

Tax-exempt organizations, other than private foundations, are, with certain exceptions for churches and other organizations, required to file Form 990 unless the organization's gross receipts do not normally exceed $25,000. An organization may file Form 990–EZ instead of Form 990 if its gross receipts during the year were less than $100,000, and its total assets at the end of the year were less than $250,000. Among the proposals being considered by the Service is raising the threshold for Form 990 (for example, to $40,000 or $100,000), and a commensurate increase in the gross receipts and total asset thresholds for filing Form 990–EZ.

The Service invites comments from tax-exempt organizations, as well as other interested parties such as entities and individuals who use information reported on Form 990 as to how to reduce the burden on tax-exempt organizations while recognizing the continuing need for information as to the existence and operations of such organizations. In addition, the Service invites suggestions for less burdensome alternative methods of periodic reporting by organizations excepted from filing Form 990 that would provide the Service with information necessary to maintain and update computer lists of exempt organizations.

The Service requests that written comments be submitted by February 23, 1998. Send submissions to CP:E:EO:P:1 (Announcement 97–115), Room 6033, Inter-

nal Revenue Service, 1111 Constitution Ave., NW, Washington, DC 20224. Submissions may be hand-delivered between the hours of 8 a.m. and 5 p.m. to CP:E:EO:P:1, (Announcement 97–115), Room 6033, Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC. Alternatively, parties may submit comments electronically via the Internet by selecting the "Tax Regs in English" option of the IRS Home Page or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

The principal author of this announcement is David Flavin of the Exempt Organizations Division, Projects Branch 1. For further information regarding this announcement contact Mr. Flavin on (202) 622-7922 (not a toll-free call).

# Definition of Terms

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

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

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

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

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

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

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

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

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

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

# Abbreviations

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

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

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1997–1 through 1997–26 will be found in Internal Revenue Bulletin 1997–27, dated July 7, 1997.

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