

Internal Revenue bulletin

Bulletin No. 1999-6
February 8, 1999

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. 99-5, page 8.

Disregarded entity to partnership. This ruling describes the federal income tax consequences when a single member limited liability company that is disregarded as an entity separate from its owner under section 301.7701-3 of the Procedure and Administration Regulations becomes an entity with more than one owner that is classified as a partnership for federal tax purposes.

Rev. Rul. 99-6, page 6.

Partnership to disregarded entity. This ruling describes the federal income tax consequences if one person purchases all of the ownership interests in a domestic limited liability company (LLC) that is classified as a partnership under section 301.7701-3 of the Procedure and Administration Regulations, causing the LLC's status as a partnership to terminate under section 708(b)(1)(A) of the Code.

Rev. Rul. 99-8, page 10.

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for February 1999.

T.D. 8799, page 12.

Final regulations relate to the treatment of certain investment income under the qualifying income provisions of section 7704 of the Code and the application of the passive activity loss rules to publicly traded partnerships.

EMPLOYEE PLANS

T.D. 8806, page 4.

Final and temporary regulations provide changes to the rules under section 411 of the Code regarding qualified retirement plan benefits that are protected from reduction by plan amendment. The changes were made necessary by the Taxpayer Relief Act of 1997.

EXEMPT ORGANIZATIONS

Announcement 99-13, page 20.

A list is given of organizations now classified as private foundations.

ESTATE TAX

REG-114663-97, page 17.

Proposed regulations under section 2056 of the Code relate to the effect of certain administration expenses on the valuation of property which qualifies for the estate tax marital or charitable deduction. A public hearing will be held on April 21, 1999.

ADMINISTRATIVE

Notice 99-10, page 16.

Low-income housing tax credit. Resident population figures for the various states for determining the 1999 calendar year (1) state housing credit ceiling under section 42(h) of the Code, and (2) private activity bond volume cap under section 146 of the Code are reproduced.

Finding Lists begin on page 24.



Department of the Treasury
Internal Revenue Service

Mission of the Service

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

and by applying the tax law with integrity and fairness to all.

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 proce-

dures 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.

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

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

The adjusted federal long-term rate is set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)-4: Section 411(d)(6) protected benefits.

T.D. 8806

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Employee Stock Ownership Plans; Section 411(d)(6) Protected Benefits (Taxpayer Relief Act of 1997); Qualified Retirement Plan Benefits

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations providing for changes to the rules regarding qualified retirement plan benefits that are protected from reduction by plan amendment, that have been made necessary by the Taxpayer Relief Act of 1997 (TRA '97). The final regulations change the ex-

isting final regulations to conform with the TRA '97 rules regarding in-kind distribution requirements for certain employee stock ownership plans, and specify the time period during which certain plan amendments for which relief has been granted by TRA '97 may be made without violating the prohibition against plan amendments that reduce accrued benefits. These final regulations affect sponsors of qualified retirement plans, employers that maintain qualified retirement plans, and qualified retirement plan participants. The amendments to the temporary regulations remove previously issued temporary regulations on the same subject.

DATES: These regulations are effective January 8, 1999.

FOR FURTHER INFORMATION CONTACT: Linda S. F. Marshall, (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 411(d)(6). These regulations change the rules under section 411(d)(6) regarding qualified retirement plan benefits that are protected from reduction by plan amendment, to take into account amendments made by the Taxpayer Relief Act of 1997 (TRA '97), Public Law 105-34, 111 Stat. 788 (1997). On September 4, 1998, temporary regulations (T.D. 8781, 1998-40 I.R.B. 4) under section 411(d)(6) were published in the **Federal Register** (63 F.R. 47172). A notice of proposed rulemaking (REG-101363-98, 1998-40 I.R.B. 10), cross-referencing the temporary regulations, was published in the **Federal Register** (63 F.R. 47214) on the same day. The temporary regulations conform the regulations to the TRA '97 amendments to section 409 regarding the general requirement that employee stock ownership plans offer distributions in the form of employer securities. In addition, the temporary regulations specify the time period during which certain plan amendments for which relief has been granted by TRA '97 may be made without violating section 411(d)(6).

One written comment responding to the notice of proposed rulemaking was received. No public hearing was requested or held. The proposed regulations under section 411(d)(6) are adopted by this Treasury decision, and the corresponding temporary regulations are removed.

Explanation of Provisions

Section 411(d)(6) provides that a plan is not treated as satisfying the requirements of section 411 if the accrued benefit of a participant is decreased by a plan amendment. Under section 411(d)(6)(B), a plan amendment that eliminates an optional form of benefit is treated as reducing accrued benefits to the extent that the amendment applies to benefits accrued as of the later of the adoption date or the effective date of the amendment. Sections 1.411(d)-4, Q&A-1(b)(1) and 1.401(a)(4)-4(e) specify that different optional forms of benefit within the meaning of section 411(d)(6)(B) result from differences in the medium of a distribution (e.g., cash or in-kind) from a plan. Section 411(d)(6)(C) provides that any tax credit employee stock ownership plan or any employee stock ownership plan is not treated as failing to meet the requirements of section 411(d)(6) merely because it modifies distribution options in a nondiscriminatory manner.

Special Rules Regarding Medium of Distribution from ESOPs

Section 409(h) contains requirements relating to distributions from tax credit employee stock ownership plans. Section 4975(e)(7) extends the requirements of section 409(h) to other employee stock ownership plans as well, and section 401(a)(23) extends the requirements of section 409(h) to qualified plans that are stock bonus plans. Under section 409(h)(1)(A), an employee stock ownership plan or other stock bonus plan generally is required to make distributions available in the form of employer securities. Prior to its amendment by TRA '97, section 409(h)(2) provided an exception to this rule in the case of an employer whose charter or bylaws restrict the ownership of substantially all outstanding employer se-

curities to employees or to a trust described in section 401(a).

Under section 1361, certain small business corporations that do not have more than 75 shareholders are eligible to elect treatment as S corporations whose tax attributes generally flow through to shareholders in accordance with the rules of subchapter S of chapter 1 of subtitle A of the Internal Revenue Code. Prior to the Small Business Job Protection Act of 1996 (SBJPA), Public Law 104-188, 110 Stat. 1755 (1996), an S corporation could not maintain an employee stock ownership plan because an S corporation could not have a qualified trust described in section 401(a) as a shareholder. SBJPA amended the requirements for S corporations, effective for tax years beginning after December 31, 1996, to permit certain tax-exempt organizations, including qualified trusts described in section 401(a), to be S corporation shareholders.

TRA '97 made an additional change to the rules governing qualified plans holding securities of an S corporation employer, to make it easier for S corporation employers to facilitate employee ownership of employer securities through qualified plans. Section 1506 of TRA '97 extends the exception of section 409(h)(2) to cover S corporations, effective for taxable years beginning after December 31, 1997. Pursuant to this change, tax credit employee stock ownership plans, employee stock ownership plans, and other stock bonus plans established and maintained by S corporation employers are not required to offer distributions in the form of employer securities.

Section 1.411(d)-4, Q&A-2(d)(2)(ii) provides an exception from the requirements of section 411(d)(6) for plan amendments that eliminate optional forms of benefit from a tax credit employee stock ownership plan, an employee stock ownership plan, or a stock bonus plan, for certain employers. Section 1.411(d)-4, Q&A-2(d)(2)(ii) applies to employers that become substantially employee-owned, if the employer otherwise meets the requirements of section 409(h)(2) with respect to restrictions on the ownership of outstanding employer stock. These regulations retain the provision in the temporary regulations to expand the exception of §1.411(d)-4, Q&A-2(d)(2)(ii) from the requirements of section 411(d)(6) to

apply to S corporations as well, to reflect the TRA '97 changes to section 409(h).

Rules for Plan Amendments Pursuant to TRA '97

Section 1541 of TRA '97 contains provisions relating to plan amendments that are adopted as a result of TRA '97. If section 1541 applies to a plan amendment, section 1541(a) provides that the plan will be treated as operated in accordance with its terms and will not fail to satisfy the requirements of section 411(d)(6) by reason of the amendment. Section 1541 applies to a plan amendment that is made pursuant to a legislative change in the pension and employee benefit provisions of TRA '97, provided the following conditions are satisfied. First, the plan amendment must be adopted before the first day of the first plan year beginning on or after January 1, 1999 (2001, in the case of a governmental plan, as defined in section 414(d)). Second, the plan must be operated in accordance with the terms of the plan amendment, beginning on the date the legislative change takes effect, or, if the amendment is not required by the legislative change, the effective date of the amendment specified by the plan. Third, the plan amendment must be made retroactively effective.

The remedial amendment period for adopting plan amendments to which section 1541 of TRA '97 applies was extended pursuant to the rules of section 401(b) in Rev. Proc. 98-14 (1998-4 I.R.B. 22). To provide a uniform time for plan amendment, these regulations add a new §1.411(d)-4, Q&A-11 to retain the rule of §1.411(d)-4T, Q&A-11 of the temporary regulations extending the time for the section 411(d)(6) relief provided by section 1541 of TRA '97 to the end of the remedial amendment period for these plan amendments.

The sole commentator raised a concern regarding whether this extension of the time period for section 411(d)(6) relief originally provided under section 1541 of TRA '97 restricts the time during which any plan amendment can be made to eliminate in-kind distributions of employer securities from employee stock ownership plans of S corporations. The extension of the time period for this section 1541 statutory relief pursuant to §1.411(d)-4, Q&A-11 does not restrict the time period during

which a plan amendment can be made to eliminate these in-kind distributions as permitted under §1.411(d)-4, Q&A-2(d)(2)(ii); to the contrary, the §1.411(d)-4, Q&A-11 extension of this statutory relief period provides an additional time period for the adoption of certain plan amendments to eliminate these in-kind distributions after these in-kind distributions have been eliminated in operation. Under the ongoing rule of §1.411(d)-4, Q&A-2(d)(2)(ii), a plan amendment to eliminate these in-kind distributions that is effective with respect to distributions payable after the date the amendment is adopted can be made at any time during taxable years of the employer beginning after December 31, 1997.

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 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, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Linda S. F. Marshall, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for

part 1 is amended by adding an entry in numerical order to read in part as follows:

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

§1.411(d)-4T also issued under 26 U.S.C. 411(d)(6). * * *

Par. 2. Section 1.411(d)-4 is amended by:

1. Revising Q&A-2(d)(2)(ii).
2. Removing the last sentence of Q&A-2(d)(3).
3. Adding Q&A-11.

The additions and revisions read as follows:

§1.411(d)-4 Section 411(d)(6) protected benefits.

* * * * *

Q-2: * * *

A-2: * * *

(d) * * *

(2) * * *

(ii) *Employer becomes substantially employee-owned or is an S corporation.*

The employer eliminates, or retains the discretion to eliminate, with respect to all participants, optional forms of benefit by substituting cash distributions for distributions in the form of employer stock with respect to benefits subject to section 409(h) in the circumstances described in paragraph (d)(1)(ii)(A) or (B) of this Q&A-2, but only if the employer otherwise meets the requirements of section 409(h)(2)—

(A) The employer becomes substantially employee-owned; or

(B) For taxable years of the employer beginning after December 31, 1997, the employer is an S corporation as defined in section 1361.

* * * * *

Q-11: To what extent may a plan amendment that is made pursuant to the Taxpayer Relief Act of 1997 (TRA '97) (Public Law 105-34, 111 Stat. 788), reduce or eliminate section 411(d)(6) protected benefits?

A-11: A plan amendment does not violate the requirements of section 411(d)(6) merely because the plan amendment reduces or eliminates section 411(d)(6) protected benefits as of the effective date of the plan amendment, provided that—

(a) The plan amendment is made pursuant to an amendment made by title XV, or subtitle H of title X, of TRA '97; and

(b) The plan amendment is adopted no later than the last day of any remedial amendment period that applies to the plan pursuant to §§1.401(b)-1 and 1.401(b)-1T for changes under TRA '97.

§1.411(d)-4T [Removed]

Par. 3. Section 1.411(d)-4T is removed.

Robert E. Wenzel,
*Deputy Commissioner of
Internal Revenue.*

Approved January 7, 1999.

Donald C. Lubick,
*Assistant Secretary of
the Treasury.*

(Filed by the Office of the Federal Register on January 7, 1999, 8:45 a.m., and published in the issue of the Federal Register for January 8, 1999, 64 F.R. 1125)

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 708.—Continuation of Partnership

26 CFR 1.708-1: *Continuation of partnership.*
(Also sections 731, 732, 735, 741, 751, 1012; 1.741-1; 301.7701-2, 301.7701-3.)

Partnership to disregarded entity.

This ruling describes the federal income tax consequences if one person purchases all of the ownership interests in a domestic limited liability company (LLC) that is classified as a partnership under section 301.7701-3 of the Procedure and Administration Regulations, causing the LLC's status as a partnership to terminate under section 708(b)(1)(A) of the Code.

Rev. Rul. 99-6

ISSUE

What are the federal income tax consequences if one person purchases all of the ownership interests in a domestic limited liability company (LLC) that is classified as a partnership under § 301.7701-3 of the Procedure and Administration Regulations, causing the LLC's status as a partnership to terminate under § 708(b)(1)(A) of the Internal Revenue Code?

FACTS

In each of the following situations, an LLC is formed and operates in a state which permits an LLC to have a single owner. Each LLC is classified as a partnership under § 301.7701-3. Neither of the LLCs holds any unrealized receivables or substantially appreciated inventory for purposes of § 751(b). For the sake of simplicity, it is assumed that neither LLC is liable for any indebtedness, nor are the assets of the LLCs subject to any indebtedness.

Situation 1. A and B are equal partners in AB, an LLC. A sells A's entire interest in AB to B for \$10,000. After the sale, the business is continued by the LLC, which is owned solely by B.

Situation 2. C and D are equal partners in CD, an LLC. C and D sell their entire interests in CD to E, an unrelated person, in exchange for \$10,000 each. After the sale, the business is continued by the LLC, which is owned solely by E.

After the sale, in both situations, no entity classification election is made under § 301.7701-3(c) to treat the LLC as an association for federal tax purposes.

LAW

Section 708(b)(1)(A) and § 1.708-1(b)(1) of the Income Tax Regulations provide that a partnership shall terminate when the operations of the partnership are discontinued and no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

Section 731(a)(1) provides that, in the case of a distribution by a partnership to a partner, gain is not recognized to the partner except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

Section 731(a)(2) provides that, in the case of a distribution by a partnership in liquidation of a partner's interest in a partnership where no property other than money, unrealized receivables (as defined in § 751(c)), and inventory (as defined in § 751(d)(2)) is distributed to the partner, loss is recognized to the extent of the excess of the adjusted basis of the partner's interest in the partnership over the sum of (A) any money distributed, and (B) the basis to the distributee, as determined under § 732, of any unrealized receivables and inventory.

Section 732(b) provides that the basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of the partner's interest in the partnership, reduced by any money distributed in the same transaction.

Section 735(b) provides that, in determining the period for which a partner has

held property received in a distribution from a partnership (other than for purposes of § 735(a)(2)), there shall be included the holding period of the partnership, as determined under § 1223, with respect to the property.

Section 741 provides that gain or loss resulting from the sale or exchange of an interest in a partnership shall be recognized by the transferor partner, and that the gain or loss shall be considered as gain or loss from a capital asset, except as provided in § 751 (relating to unrealized receivables and inventory items).

Section 1.741-1(b) provides that § 741 applies to the transferor partner in a two-person partnership when one partner sells a partnership interest to the other partner, and to all the members of a partnership when they sell their interests to one or more persons outside the partnership.

Section 301.7701-2(c)(1) provides that, for federal tax purposes, the term "partnership" means a business entity (as the term is defined in § 301.7701-2(a)) that is not a corporation and that has at least two members.

In *Edwin E. McCauslen v. Commissioner*, 45 T.C. 588 (1966), one partner in an equal, two-person partnership died, and his partnership interest was purchased from his estate by the remaining partner. The purchase caused a termination of the partnership under § 708(b)(1)(A). The Tax Court held that the surviving partner did not purchase the deceased partner's interest in the partnership, but that the surviving partner purchased the partnership assets attributable to the interest. As a result, the surviving partner was not permitted to succeed to the partnership's holding period with respect to these assets.

Rev. Rul. 67-65, 1967-1 C.B. 168, also considered the purchase of a deceased partner's interest by the other partner in a two-person partnership. The Service ruled that, for the purpose of determining the purchaser's holding period in the assets attributable to the deceased partner's interest, the purchaser should treat the transaction as a purchase of the assets attributable to the interest. Accordingly, the purchaser was not permitted to succeed to the partnership's holding period with respect to these assets. See also Rev. Rul. 55-68, 1955-1 C.B. 372.

Situation 1. The AB partnership terminates under § 708(b)(1)(A) when B purchases A's entire interest in AB. Accordingly, A must treat the transaction as the sale of a partnership interest. Reg. § 1.741-1(b). A must report gain or loss, if any, resulting from the sale of A's partnership interest in accordance with § 741.

Under the analysis of *McCauslen* and Rev. Rul. 67-65, for purposes of determining the tax treatment of B, the AB partnership is deemed to make a liquidating distribution of all of its assets to A and B, and following this distribution, B is treated as acquiring the assets deemed to have been distributed to A in liquidation of A's partnership interest.

B's basis in the assets attributable to A's one-half interest in the partnership is \$10,000, the purchase price for A's partnership interest. Section 1012. Section 735(b) does not apply with respect to the assets B is deemed to have purchased from A. Therefore, B's holding period for these assets begins on the day immediately following the date of the sale. See Rev. Rul. 66-7, 1966-1 C.B. 188, which provides that the holding period of an asset is computed by excluding the date on which the asset is acquired.

Upon the termination of AB, B is considered to receive a distribution of those assets attributable to B's former interest in AB. B must recognize gain or loss, if any, on the deemed distribution of the assets to the extent required by § 731(a). B's basis in the assets received in the deemed liquidation of B's partnership interest is determined under § 732(b). Under § 735(b), B's holding period for the assets attributable to B's one-half interest in AB includes the partnership's holding period for such assets (except for purposes of § 735(a)(2)).

Situation 2. The CD partnership terminates under § 708(b)(1)(A) when E purchases the entire interests of C and D in CD. C and D must report gain or loss, if any, resulting from the sale of their partnership interests in accordance with § 741.

For purposes of classifying the acquisition by E, the CD partnership is deemed to make a liquidating distribution of its assets to C and D. Immediately following

this distribution, *E* is deemed to acquire, by purchase, all of the former partnership's assets. Compare Rev. Rul. 84-111, 1984-2 C.B. 88 (Situation 3), which determines the tax consequences to a corporate transferee of all interests in a partnership in a manner consistent with *McCauslen*, and holds that the transferee's basis in the assets received equals the basis of the partnership interests, allocated among the assets in accordance with § 732(c).

E's basis in the assets is \$20,000 under § 1012. *E*'s holding period for the assets begins on the day immediately following the date of sale.

DRAFTING INFORMATION

The principal author of this revenue ruling is Matthew Lay of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Lay at (202) 622-3050 (not a toll-free call).

Section 721.—Nonrecognition of Gain or Loss on Contribution

26 CFR 1.721-1: Nonrecognition of gain or loss on contribution.
(Also sections 722, 723, 1001, 1012, 1223, 7701; 1.1223-1, 301.7701-3.)

Disregarded entity to partnership. This ruling describes the federal income tax consequences when a single member limited liability company that is disregarded as an entity separate from its owner under section 301.7701-3 of the Procedure and Administration Regulations becomes an entity with more than one owner that is classified as a partnership for federal tax purposes.

Rev. Rul. 99-5

ISSUE

What are the federal income tax consequences when a single member domestic limited liability company (LLC) that is disregarded for federal tax purposes as an entity separate from its owner under § 301.7701-3 of the Procedure and Administration Regulations becomes an entity with more than one owner that is classified as a partnership for federal tax purposes?

FACTS

In each of the following two situations, an LLC is formed and operates in a state which permits an LLC to have a single owner. Each LLC has a single owner, *A*, and is disregarded as an entity separate from its owner for federal tax purposes under § 301.7701-3. In both situations, the LLC would not be treated as an investment company (within the meaning of § 351) if it were incorporated. All of the assets held by each LLC are capital assets or property described in § 1231. For the sake of simplicity, it is assumed that neither LLC is liable for any indebtedness, nor are the assets of the LLCs subject to any indebtedness.

Situation 1. *B*, who is not related to *A*, purchases 50% of *A*'s ownership interest in the LLC for \$5,000. *A* does not contribute any portion of the \$5,000 to the LLC. *A* and *B* continue to operate the business of the LLC as co-owners of the LLC.

Situation 2. *B*, who is not related to *A*, contributes \$10,000 to the LLC in exchange for a 50% ownership interest in the LLC. The LLC uses all of the contributed cash in its business. *A* and *B* continue to operate the business of the LLC as co-owners of the LLC.

After the sale, in both situations, no entity classification election is made under § 301.7701-3(c) to treat the LLC as an association for federal tax purposes.

LAW AND ANALYSIS

Section 721(a) generally provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of the money and the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of the property to the contributing partner at the

time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 1001(a) provides that the gain or loss from the sale or other disposition of property shall be the difference between the amount realized therefrom and the adjusted basis provided in § 1011.

Section 1223(1) provides that, in determining the holding period of a taxpayer who receives property in an exchange, there shall be included the period for which the taxpayer held the property exchanged if the property has the same basis in whole or in part in the taxpayer's hands as the property exchanged, and the property exchanged at the time of the exchange was a capital asset or property described in § 1231.

Section 1223(2) provides that, regardless of how a property is acquired, in determining the holding period of a taxpayer who holds the property, there shall be included the period for which such property was held by any other person if the property has the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person.

HOLDING(S)

Situation 1. In this situation, the LLC, which, for federal tax purposes, is disregarded as an entity separate from its owner, is converted to a partnership when the new member, *B*, purchases an interest in the disregarded entity from the owner, *A*. *B*'s purchase of 50% of *A*'s ownership interest in the LLC is treated as the purchase of a 50% interest in each of the LLC's assets, which are treated as held directly by *A* for federal tax purposes. Immediately thereafter, *A* and *B* are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

Under § 1001, *A* recognizes gain or loss from the deemed sale of the 50% interest in each asset of the LLC to *B*.

Under § 721(a), no gain or loss is recognized by *A* or *B* as a result of the conversion of the disregarded entity to a partnership.

Under § 722, *B*'s basis in the partnership interest is equal to \$5,000, the amount paid by *B* to *A* for the assets

which *B* is deemed to contribute to the newly-created partnership. *A*'s basis in the partnership interest is equal to *A*'s basis in *A*'s 50% share of the assets of the LLC.

Under § 723, the basis of the property treated as contributed to the partnership by *A* and *B* is the adjusted basis of that property in *A*'s and *B*'s hands immediately after the deemed sale.

Under § 1223(1), *A*'s holding period for the partnership interest received includes *A*'s holding period in the capital assets and property described in § 1231 held by the LLC when it converted from an entity that was disregarded as an entity separate from *A* to a partnership. *B*'s holding period for the partnership interest begins on the day following the date of *B*'s purchase of the LLC interest from *A*. See Rev. Rul. 66-7, 1966-1 C.B. 188, which provides that the holding period of a purchased asset is computed by excluding the date on which the asset is acquired. Under § 1223(2), the partnership's holding period for the assets deemed transferred to it includes *A*'s and *B*'s holding periods for such assets.

Situation 2. In this situation, the LLC is converted from an entity that is disregarded as an entity separate from its owner to a partnership when a new member, *B*, contributes cash to the LLC. *B*'s contribution is treated as a contribution to a partnership in exchange for an ownership interest in the partnership. *A* is treated as contributing all of the assets of the LLC to the partnership in exchange for a partnership interest.

Under § 721(a), no gain or loss is recognized by *A* or *B* as a result of the conversion of the disregarded entity to a partnership.

Under § 722, *B*'s basis in the partnership interest is equal to \$10,000, the amount of cash contributed to the partnership. *A*'s basis in the partnership interest is equal to *A*'s basis in the assets of the LLC which *A* was treated as contributing to the newly-created partnership.

Under § 723, the basis of the property contributed to the partnership by *A* is the adjusted basis of that property in *A*'s hands. The basis of the property contributed to the partnership by *B* is \$10,000, the amount of cash contributed to the partnership.

Under § 1223(1), *A*'s holding period for the partnership interest received includes *A*'s holding period in the capital and § 1231 assets deemed contributed when the disregarded entity converted to a partnership. *B*'s holding period for the partnership interest begins on the day following the date of *B*'s contribution of money to the LLC. Under § 1223(2), the partnership's holding period for the assets transferred to it includes *A*'s holding period.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Matthew Lay of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) and Mark D. Harris of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling contact Mr. Lay at 202-622-3050 (not a toll-free call).

Section 722.—Basis of Contributing Partner's Interest

26 CFR 1.722-1: Basis of contributing partner's interest.

Tax consequences when a single member domestic limited liability company that is disregarded as an entity separate from its owner becomes an entity with more than one owner that is classified as a partnership. See Rev. Rul. 99-5, page 8.

Section 723.—Basis of Property Contributed to Partnership

26 CFR 1.723-1: Basis of property contributed to partnership.

Tax consequences when a single member domestic limited liability company that is disregarded as an entity separate from its owner becomes an entity with more than one owner that is classified as a partnership. See Rev. Rul. 99-5, page 8.

Section 731.—Extent of Recognition of Gain or Loss on Distribution

26 CFR 1.731-1: Extent of recognition of gain or loss on distribution.

Tax consequences if one person purchases all of the ownership interests in a domestic limited liability company that is classified as a partnership. See Rev. Rul. 99-6, page 6.

Section 732.—Basis of Distributed Property Other Than Money

26 CFR 1.732-1: Basis of distributed property other than money.

Tax consequences if one person purchases all of the ownership interests in a domestic limited liability company that is classified as a partnership. See Rev. Rul. 99-6, page 6.

Section 735.—Character of Gain or Loss on Disposition of Distributed Property

26 CFR 1.735-1: Character of gain or loss on disposition of distributed property.

Tax consequences if one person purchases all of the ownership interests in a domestic limited liability company that is classified as a partnership. See Rev. Rul. 99-6, page 6.

Section 741.—Recognition and Character of Gain or Loss on Sale or Exchange

26 CFR 1.741-1: Recognition and character of gain or loss on sale or exchange.

Tax consequences if one person purchases all of the ownership interests in a domestic limited liability company that is classified as a partnership. See Rev. Rul. 99-6, page 6.

Section 751.—Unrealized Receivables and Inventory Items

26 CFR 1.751-1: Unrealized receivables and inventory items.

Tax consequences if one person purchases all of the ownership interests in a domestic limited liability company that is classified as a partnership. See Rev. Rul. 99-6, page 6.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-

term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001-1: *Computation of gain or loss.*

Tax consequences when a single member domestic limited liability company that is disregarded as an entity separate from its owner becomes an entity with more than one owner that is classified as a partnership. See Rev. Rul. 99-5, page 8.

Section 1012.—Basis of Property—Cost

26 CFR 1.1012-1: *Basis of property.*

Tax consequences when a single member domestic limited liability company that is disregarded as an entity separate from its owner becomes an entity with more than one owner that is classified as a partnership. See Rev. Rul. 99-5, page 8.

Tax consequences if one person purchases all of the ownership interests in a domestic limited liability

company that is classified as a partnership. See Rev. Rul. 99-6, page 6.

Section 1223.—Basis Period of Property

26 CFR 1.1223-1: *Determination of period for which capital assets are held.*

Tax consequences when a single member domestic limited liability company that is disregarded as an entity separate from its owner becomes an entity with more than one owner that is classified as a partnership. See Rev. Rul. 99-5, page 8.

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

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

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other

sections of the Code, tables set forth the rates for February 1999.

Rev. Rul. 99-8

This revenue ruling provides various prescribed rates for federal income tax purposes for February 1999 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 99-8 TABLE 1

Applicable Federal Rates (AFR) for February 1999

Period for Compounding

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	4.62%	4.57%	4.54%	4.53%
110% AFR	5.09%	5.03%	5.00%	4.98%
120% AFR	5.56%	5.48%	5.44%	5.42%
130% AFR	6.03%	5.94%	5.90%	5.87%
<i>Mid-Term</i>				
AFR	4.71%	4.66%	4.63%	4.62%
110% AFR	5.20%	5.13%	5.10%	5.08%
120% AFR	5.67%	5.59%	5.55%	5.53%
130% AFR	6.15%	6.06%	6.01%	5.98%
150% AFR	7.11%	6.99%	6.93%	6.89%
175% AFR	8.33%	8.16%	8.08%	8.02%
<i>Long-Term</i>				
AFR	5.24%	5.17%	5.14%	5.12%
110% AFR	5.77%	5.69%	5.65%	5.62%
120% AFR	6.30%	6.20%	6.15%	6.12%
130% AFR	6.83%	6.72%	6.66%	6.63%

REV. RUL. 99-8 TABLE 2
Adjusted AFR for February 1999

Period for Compounding

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	3.13%	3.11%	3.10%	3.09%
Mid-term adjusted AFR	3.87%	3.83%	3.81%	3.80%
Long-term adjusted AFR	4.71%	4.66%	4.63%	4.62%

REV. RUL. 99-8 TABLE 3

Rates Under Section 382 for February 1999

Adjusted federal long-term rate for the current month	4.71%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.71%

REV. RUL. 99-8 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for February 1999

Appropriate percentage for the 70% present value low-income housing credit	8.16%
Appropriate percentage for the 30% present value low-income housing credit	3.50%

REV. RUL. 99-8 TABLE 5

Rate Under Section 7520 for February 1999

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.6%
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Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99–8, page 10.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99–8, page 10.

Section 7701.—Definitions

26 CFR 7701–3: Classification of certain business entities.

Tax consequences when a single member domestic limited liability company that is disregarded as an entity separate from its owner becomes an entity with more than one owner that is classified as a partnership. See Rev. Rul. 99–5, page 8.

Tax consequences if one person purchases all of the ownership interests in a domestic limited liability company that is classified as a partnership. See Rev. Rul. 99–6, page 6.

Section 7704.—Certain Publicly Traded Partnerships Treated as Corporations

26 CFR 1.7704–3: Qualifying income.

T.D. 8799

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Certain Investment Income Under the Qualifying Income Provisions of Section 7704 and the Application of the Passive Activity Loss Rules to Publicly Traded Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the treatment of certain investment income under the qualifying income provisions of section

7704 and the application of the passive activity loss rules to publicly traded partnerships. These regulations provide guidance on calculating a publicly traded partnership's qualifying income under section 7704. The regulations will affect the classification of certain partnerships for federal tax purposes and also will affect the passive activity loss limitations with respect to items attributable to publicly traded partnerships.

DATES: *Effective Date:* These regulations are effective, December 17, 1998.

Applicability Dates: See Effective Dates under SUPPLEMENTARY INFORMATION of the preamble.

FOR FURTHER INFORMATION CONTACT: Christopher Kelley or Terri Belanger at (202) 622-3080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations add §1.7704–3 to the Income Tax Regulations (26 CFR part 1) relating to the definition of qualifying income for publicly traded partnerships under section 7704(d) of the Internal Revenue Code (Code). The final regulations also amend §1.469-10 of the Income Tax Regulations relating to the application of section 469 to publicly traded partnerships.

On December 19, 1997, proposed regulations (REG–105163–97, 1998–8 I.R.B. 31) were published in the Federal Register (62 F.R. 66575). A number of written comments were received on the proposed regulations under section 7704(d). Two speakers provided testimony at a public hearing held on April 28, 1998. After consideration of all the comments, the proposed regulations under section 7704 are adopted, as revised by this Treasury decision.

No comments were received on the proposed regulations under section 469. The proposed regulations under section 469 are adopted without revision by this Treasury decision.

Explanation of Revisions and Summary of Comments

1. *Determination of Gross Income for Purposes of Section 7704(c)(2)*

a. Capital Losses

Section 7704(d)(1)(F) provides that, except as otherwise provided, the term *qualifying income* includes any gain from the sale or disposition of a capital asset (or property described in section 1231(b)) held for the production of income described in section 7704(d). Several commentators requested clarification as to how capital losses incurred by the partnership are treated in determining gross income of the partnership for purposes of section 7704(c)(2). The final regulations clarify that, in general, all losses are ignored in the computation of gross income.

b. Straddles

The proposed regulations requested comments on the appropriate way to compute the gross income for a partnership that makes a mixed straddle account election under §1.1092(b)–4T. The final regulations provide that, for purposes of applying the general rule that a capital gain on an investment is taken into account but a capital loss is not, certain rules shall apply that generally net capital gains and losses recognized in a taxable year with respect to a straddle. This treatment applies to all straddles, not just mixed straddle accounts, and to other interests in property that produce a substantial diminution of the partnership's risk of loss similar to that of straddles. In addition, the final regulations contain a wash sale rule for gains in certain straddle and straddle-like transactions. This rule provides that, for purposes of section 7704(c)(2), if a partnership recognizes gain with respect to the disposition of one or more positions of a straddle or similar arrangement, and the partnership acquires a substantially similar position or positions within a period beginning 30 days before and ending 30 days after the date of the disposition, then the gain shall not be taken into account to the extent of the amount of unrecognized loss (as of the close of the taxable year) in one or more offsetting positions of the straddle or similar arrangement.

c. Mark-to-Market

The proposed regulations provide that qualifying income includes capital gain from the sale of stock. The final regulations clarify that gain recognized with re-

spect to a position that is marked to market (for example, under section 475(f), section 1256, section 1259, or section 1296) will not fail to be qualifying income solely because there is no sale or disposition.

d. Certain Ordinary Income

Under certain provisions of the Code, capital gain or loss with respect to certain transactions is recharacterized as ordinary income or loss. However, such gain or loss may be recognized with respect to a capital asset in a manner that is consistent with section 7704(d)(1)(F). Accordingly, the final regulations provide that gain will not fail to be qualifying income solely because it is characterized as ordinary income under section 475(f), section 988, section 1258, or section 1296.

2. *Income Derived from Securities Lending Activities*

Several commentators requested that the final regulations clarify that income from securities lending activities of a trader is qualifying income. Section 7704(d)(4) provides that qualifying income includes income that qualifies under section 851(b)(2). Section 851(b)(2), which includes income from security loans, does not specifically state that it applies to the business of trading, as opposed to the business of investing. Thus, commentators have suggested that there is uncertainty under section 7704 as to whether income from security loans from the business of trading is qualifying income.

The IRS and Treasury Department believe that section 851(b)(2) generally encompasses income from the business of trading as well as investing. Thus, income from the securities lending activities of a trader will be qualifying income under section 7704. A special provision in these final regulations for this income is not necessary and could create a negative implication as to the qualification of trading income under section 851(b)(2) generally. Accordingly, the final regulations do not adopt this comment.

3. *Income Derived from Investments in Foreign Corporations*

One commentator requested that the final regulations clarify that income from investments in foreign corporations is qualifying income. Because taxable in-

come may arise with respect to an investment in a foreign corporation that may not literally constitute a dividend, the commentator suggested that it is unclear whether these investments generate qualifying income under section 7704(d). Specifically, the commentator requested clarification regarding whether a U.S. shareholder would have qualifying income from an inclusion under (1) section 551 (foreign personal holding company income); (2) section 951(a)(1)(A) or (B) (subpart F income or a section 956 amount); (3) section 1291 (excess distributions of a passive foreign investment company (PFIC)); and (4) section 1293 (earnings of a PFIC that is a qualified electing fund). The commentator requested that the final regulations clarify that income realized under these tax regimes with respect to stock ownership in a foreign corporation is included in the definition of qualifying income under section 7704(d).

Section 551(b) characterizes amounts included in gross income under section 551(a) as dividends for federal tax purposes. Thus, an inclusion under section 551 is qualifying income under section 7704(d)(1)(B). No clarification is necessary in the final regulations.

Section 851(b)(2), which is cross-referenced in section 7704(d), provides rules on the extent to which certain inclusions of subpart F income under section 951(a)(1)(A)(i) and certain inclusions under section 1293(a) are treated as dividends and, thus, qualifying income for purposes of section 851(b)(2). Any expansion of qualifying income with respect to investments in foreign corporations should be addressed under section 851(b)(2) and the regulations thereunder. Accordingly, the final regulations do not adopt this comment.

4. *Limitation on the Definition of Qualifying Income*

The proposed regulations provide that qualifying income includes capital gain from the sale of stock, income from holding annuities, income from notional principal contracts, and other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner. Several commentators stated that partnerships must know that an investment generates qualifying

income before entering into the transaction. Because passive-type investments evolve constantly and rapidly, the commentators suggested that a requirement that a type of investment generates qualifying income only to the extent determined by the Commissioner creates uncertainty for partnerships considering new investments. Thus, these commentators requested that the final regulations not include this restriction in the definition of qualifying income.

The IRS and Treasury Department do not believe that the language in the proposed regulations creates significant uncertainty in the definition of qualifying income. Instead, the standard in the proposed regulations provides necessary flexibility to consider the effect of new types of financial investments as such investments evolve. The IRS and Treasury Department do not believe that it would be appropriate to create a broader and more generic rule that would allow taxpayers to determine for themselves whether new types of investments generate qualifying income. Thus, the final regulations do not adopt this comment.

5. *List of Specific Items Generating Qualifying Income*

Several commentators requested that the final regulations expand the list of specific investments that generate qualifying income. The IRS and Treasury Department do not believe that it is appropriate to expand the list of specific investments enumerated in the proposed regulations. Therefore, the final regulations do not adopt this comment.

6. *Partnership Reporting Requirements*

Several commentators indicated that the current reporting requirements for partnerships do not specifically compel a lower-tier partnership to provide the data necessary for an upper-tier partnership to determine whether it meets the gross income requirement of section 7704(c)(2). These commentators requested that the final regulations specifically require a lower-tier partnership to report in a level of detail that would permit an upper-tier partnership to make the necessary calculations.

The final regulations do not adopt this comment. The current reporting requirements for a partnership in §1.6031(b)–

1T(a)(3)(ii) require a partnership to furnish its partners with statements that include, to the extent provided by form or the accompanying instructions, any additional information that a partner may need to apply particular provisions of the Code with respect to items related to the partnership. The instructions to Form 1065, "U.S. Partnership Return of Income," specifically require a partnership to include on a Schedule K-1 any information a partner may need to file its return that is not shown anywhere else on the schedule. The information that an upper-tier partnership needs to make its gross income calculations must be provided by the lower-tier partnership under the current reporting requirements. An additional reporting requirement in these final regulations is not necessary.

7. *Private Placement Safe Harbor under §1.7704-1(h)(1)(ii)*

Several commentators requested that the final regulations amend the requirements of the private placement safe harbor under §1.7704-1(h)(1) to reflect the adoption of new rules by the Securities and Exchange Commission regarding knowledgeable employees. Specifically, the commentators requested that the private placement safe harbor be amended to provide that knowledgeable employees are not counted for purposes of the 100 partner limitation. This issue is beyond the scope of these final regulations. Therefore, the final regulations do not adopt this comment.

8. *Effective Dates*

The proposed regulations provide that the regulations will be effective for taxable years of a partnership beginning on or after the date final regulations are published in the **Federal Register**. Commentators stated that this effective date would preclude taxpayers from relying upon the revised definition of qualifying income in the proposed regulations until the regulations are final. These commentators requested that the effective date of the regulations be changed so that a partnership may rely upon the revised definition of qualifying income for taxable years beginning on or after the date the regulations were published as proposed regulations in the **Federal Register**.

The final regulations provide that these regulations apply to taxable years of a partnership beginning on or after, December 17, 1998. However, in response to the comments, the final regulations also include a provision that allows a partnership to apply the regulations retroactively.

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 regulations do not impose a collection of information on small entities, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Christopher Kelley and Terri Belanger, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

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

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

Par. 2. Section 1.469-10 is revised to read as follows:

§1.469-10 Application of section 469 to publicly traded partnerships.

(a) [Reserved].

(b) *Publicly traded partnership*—(1) *In general*. For purposes of section 469(k), a partnership is a publicly traded partnership only if the partnership is a publicly traded partnership as defined in §1.7704-1.

(2) *Effective date*. This section applies

for taxable years of a partnership beginning on or after, December 17, 1998.

Par. 3. Section 1.7704-3 is added to read as follows:

§1.7704-3 Qualifying income.

(a) *Certain investment income*—(1) *In general*. For purposes of section 7704(d)(1), qualifying income includes capital gain from the sale of stock, income from holding annuities, income from notional principal contracts (as defined in §1.446-3), and other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner. Income from a notional principal contract is included in qualifying income only if the property, income, or cash flow that measures the amounts to which the partnership is entitled under the contract would give rise to qualifying income if held or received directly by the partnership.

(2) *Limitations*. Qualifying income described in paragraph (a)(1) of this section does not include income derived in the ordinary course of a trade or business. For purposes of the preceding sentence, income derived from an asset with respect to which the partnership is a broker, market maker, or dealer is income derived in the ordinary course of a trade or business; income derived from an asset with respect to which the taxpayer is a trader or investor is not income derived in the ordinary course of a trade or business.

(b) *Calculation of gross income and qualifying income*—(1) *Treatment of losses*. Except as otherwise provided in this section, in computing the gross income and qualifying income of a partnership for purposes of section 7704(c)(2) and this section, losses do not enter into the computation.

(2) *Certain positions that are marked to market*. Gain recognized with respect to a position that is marked to market (for example, under section 475(f), 1256, 1259, or 1296) shall not fail to be qualifying income solely because there is no sale or disposition of the position.

(3) *Certain items of ordinary income*. Gain recognized with respect to a capital asset shall not fail to be qualifying income solely because it is characterized as ordinary income under section 475(f), 988, 1258, or 1296.

(4) *Straddles*. In computing the gross income and qualifying income of a partnership for purposes of section 7704(c)(2) and this section, a straddle (as defined in section 1092(c)) shall be treated as set forth in this paragraph (b)(4). For purposes of the preceding sentence, two or more straddles that are part of a larger straddle shall be treated as a single straddle. The amount of the gain from any straddle to be taken into account shall be computed as follows:

(i) *Straddles other than mixed straddle accounts*. With respect to each straddle (whether or not a straddle during the taxable year) other than a mixed straddle account, the amount of gain taken into account shall be the excess, if any, of gain recognized during the taxable year with respect to property that was at any time a position in that straddle over any loss recognized during the taxable year with respect to property that was at any time a position in that straddle (including loss realized in an earlier taxable year).

(ii) *Mixed straddle accounts*. With respect to each mixed straddle account (as defined in §1.1092(b)-4T(b)), the amount of gain taken into account shall be the annual account gain for that mixed straddle account, computed pursuant to §1.1092(b)-4T(c)(2).

(5) *Certain transactions similar to straddles*. In computing the gross income and qualifying income of a partnership for purposes of section 7704(c)(2) and this

section, related interests in property (whether or not personal property as defined in section 1092(d)(1)) that produce a substantial diminution of the partnership's risk of loss similar to that of a straddle (as defined in section 1092(c)) shall be combined so that the amount of gain taken into account by the partnership in computing its gross income shall be the excess, if any, of gain recognized during the taxable year with respect to such interests over any loss recognized during the taxable year with respect to such interests.

(6) *Wash sale rule*—(i) *Gain not taken into account*. Solely for purposes of section 7704(c)(2) and this section, if a partnership recognizes gain in a section 7704 wash sale transaction with respect to one or more positions in either a straddle (as defined in section 1092(c)) or an arrangement described in paragraph (b)(5) of this section, then the gain shall not be taken into account to the extent of the amount of unrecognized loss (as of the close of the taxable year) in one or more offsetting positions of the straddle or arrangement described in paragraph (b)(5) of this section.

(ii) *Section 7704 wash sale transaction*. For purposes of this paragraph (b)(6), a section 7704 wash sale transaction is a transaction in which—

(A) A partnership disposes of one or more positions of a straddle (as defined in section 1092(c)) or one or more related positions described in paragraph (b)(5) of this section; and

(B) The partnership acquires a substantially similar position or positions within a period beginning 30 days before the date of the disposition and ending 30 days after such date.

(c) *Effective date*. This section applies to taxable years of a partnership beginning on or after, December 17, 1998. However, a partnership may apply this section in its entirety for all of the partnership's open taxable years beginning after any earlier date selected by the partnership.

Robert E. Wenzel,
Deputy Commissioner of
Internal Revenue.

Approved December 7, 1998.

Donald C. Lubick,
Assistant Secretary of
the Treasury,
(Tax Policy).

(Filed by the Office of the Federal Register on December 16, 1998, 8:45 a.m., and published in the issue of the Federal Register for December 17, 1998, 63 F.R. 69551)

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Part III. Administrative, Procedural, and Miscellaneous

Low-Income Housing Tax Credit—1999 Calendar Year Resident Population Estimates

Notice 99-10

This notice informs (1) state and local housing credit agencies that allocate low-income housing tax credits under § 42 of the Internal Revenue Code and (2) states and other issuers of tax-exempt private activity bonds under § 141, of the proper population figures to be used for calculating the 1999 calendar year population-based component of the state housing credit ceiling (Credit Ceiling) under § 42(h)(3)(C)(i) and the 1999 calendar year volume cap (Volume Cap) under § 146.

The population figures both for the population-based component of the Credit Ceiling and for the Volume Cap are determined by reference to § 146(j). That section provides generally that determinations of population for any calendar year are made on the basis of the most recent census estimate of the resident population of a state (or issuing authority) released by the Bureau of the Census before the beginning of such calendar year.

The proper population figures for calculating the Credit Ceiling and the Volume Cap for the 1999 calendar year are the estimates of the resident population of states for July 1, 1998, released by the

Bureau of the Census on December 31, 1998, in press release CB98-242. For convenience, these estimates are reprinted below.

Resident Population Estimates for July 1, 1998

<i>State</i>	<i>Population</i>
Alabama	4,351,999
Alaska	614,010
Arizona	4,668,631
Arkansas	2,538,303
California	32,666,550
Colorado	3,970,971
Connecticut	3,274,069
Delaware	743,603
D.C.	523,124
Florida	14,915,980
Georgia	7,642,207
Hawaii	1,193,001
Idaho	1,228,684
Illinois	12,045,326
Indiana	5,899,195
Iowa	2,862,447
Kansas	2,629,067
Kentucky	3,936,499
Louisiana	4,368,967
Maine	1,244,250
Maryland	5,134,808
Massachusetts	6,147,132
Michigan	9,817,242
Minnesota	4,725,419
Mississippi	2,752,092
Missouri	5,438,559

Montana	880,453
Nebraska	1,662,719
Nevada	1,746,898
New Hampshire	1,185,048
New Jersey	8,115,011
New Mexico	1,736,931
New York	18,175,301
North Carolina	7,546,493
North Dakota	638,244
Ohio	11,209,493
Oklahoma	3,346,713
Oregon	3,281,974
Pennsylvania	12,001,451
Rhode Island	988,480
South Carolina	3,835,962
South Dakota	738,171
Tennessee	5,430,621
Texas	19,759,614
Utah	2,099,758
Vermont	590,883
Virginia	6,791,345
Washington	5,689,263
West Virginia	1,811,156
Wisconsin	5,223,500
Wyoming	480,907

The principal authors of this notice are Christopher J. Wilson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) and Timothy L. Jones of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this notice contact Mr. Wilson on (202) 622-3040 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Marital Deduction; Valuation of Interest Passing to Surviving Spouse

REG-114663-97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the effect of certain administration expenses on the valuation of property which qualifies for the estate tax marital or charitable deduction. The proposed regulations define estate transmission expenses and estate management expenses and provide that estate transmission expenses, but not estate management expenses, reduce the value of property for marital and charitable deduction purposes. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by February 16, 1999. Outlines of topics to be discussed at the public hearing scheduled for April 21, 1999, at 10 a.m., must be received by March 31, 1999.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG-114663-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-114663-97), 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 http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Deborah Ryan (202) 622-3090; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On March 18, 1997, the Supreme Court of the United States issued its decision in *Commissioner v. Estate of Hubert*, 520 U.S. 93 (1997) (1997-32 I.R.B. 8), in which it considered the proper interpretation of §20.2056(b)-4(a) of the Estate Tax Regulations. On November 24, 1997, the IRS issued Notice 97-63 (1997-47 I.R.B. 6), requesting comments on alternatives for amending §20.2056(b)-4(a) in light of the Supreme Court's *Estate of Hubert* decision.

Section 2056(b)(4) provides that, in determining the value of an interest in property which passes from the decedent to the surviving spouse for purposes of the marital deduction, account must be taken of any encumbrance on the property or any obligation imposed on the surviving spouse by the decedent with respect to the property. Section 20.2056(b)-4(a) of the Estate Tax Regulations amplifies this rule by providing that account must be taken of the effect of any material limitations on the surviving spouse's right to the income from the property. The regulation provides, for example, that there may be a material limitation on the surviving spouse's right to the income from marital trust property where the income is used to pay administration expenses during the period between the date of the decedent's death and the date of distribution of the assets to the trustee.

The facts in *Estate of Hubert* are similar to a common fact pattern wherein the decedent's will provides for a residuary bequest to a marital trust which qualifies for the marital deduction and also provides that estate administration expenses are to be paid from the residuary estate. Further, the will (or state law) permits the executor to use the income generated by the residuary estate (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 the executor's use of the income to pay estate administration expenses was a material limitation on the surviving spouse's right to the income which would reduce the marital deduction under §20.2056(b)-4(a).

The issue in *Estate of Hubert* also involved the estate tax charitable deduction, and the proposed regulations relate to the valuation of property for both marital and charitable deduction purposes. However, for simplicity and clarity, this discussion focuses on the provisions of the estate tax marital deduction.

In *Estate of Hubert*, 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 the 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 Notice 97-63 (November 24, 1997), the IRS requested comments on possible approaches for proposed regulations in light of the *Estate of Hubert* decision. Notice 97-63 suggested three alternative approaches for determining when the use of income to pay administration expenses constitutes a material limitation on the surviving spouse's right to income. One approach distinguished between administration expenses that are properly charged to principal and those that are properly charged to income and provided that there is a material limitation on the surviving spouse's right to income if income is used to pay an estate administration expense that is properly charged to principal. A second approach provided a *de minimis* safe harbor amount of income that may be

used to pay administration expenses without constituting a material limitation on the surviving's spouse's right to income. A third approach provided that any charge to income for the payment of administration expenses constitutes a material limitation on the spouse's right to income.

Notice 97-63 also asked for comments on whether the test for materiality should be based on a comparison of the relative amounts of the income and the expenses charged to the income; whether materiality should be based on projections as of the date of death rather than on the facts that develop afterwards; and whether present value principles should be applied.

In response to Notice 97-63, several commentators suggested that local law should be determinative of whether an expense is a proper charge to income or principal. If the testamentary document directs the executor to charge expenses to income, and the charge is allowed under applicable local law, then the charge to income should not be treated as a material limitation on the spouse's right to income.

This approach was not adopted because statutory provisions relating to income and principal may vary from state to state, and this would result in disparate treatment of estates that are similarly situated but governed by different state law. Moreover, in states that have adopted some form of the Uniform Principal and Income Act, the definitions of principal and income, and the allocation of expenses thereto, can be specified in the will or trust instrument and given the effect of state law. Thus, simply following state law was thought to be too malleable to protect the policies underlying the marital and charitable deductions.

Several commentators agreed with the *de minimis* safe harbor approach whereby a certain amount of income could be used to pay administration expenses without materially limiting the surviving spouse's right to the income. Under this approach, the safe harbor amount is determined in two steps: first, the present value of the surviving spouse's income interest for life is determined using actuarial principles and, second, the resulting amount is multiplied by a percentage, for example, 5 percent.

The proposed regulations do not adopt this approach. Although a *de minimis* safe harbor approach would provide a

bright line test for determining materiality in the context of the marital deduction, it is unclear how this approach would apply for charitable deduction purposes because there is no measuring life for valuing the income interest.

One commentator suggested that, consistent with the plurality opinion in *Estate of Hubert*, the test for materiality should be quantitative, based upon a comparison between the amount of income charged with administration expenses and the total income earned during administration. The commentator, however, considered the requirement that projected income and expenses be presently valued to be impractical, complex, and uncertain. Another commentator considered a quantitative test to be impractical. A third commentator suggested that a quantitative test would require a factual determination in each case and, as a result, the period of estate administration would be greatly prolonged.

Because these tests for materiality appear to be complex and difficult to administer, the proposed regulations adopt neither a quantitative test nor a test based on present values of projected income and expenses.

Many commentators opposed an approach in which every charge to income is a material limitation on the spouse's right to income. Two commentators contended that adoption of this approach would effectively overrule the result in *Estate of Hubert*.

One commentator suggested the approach adopted in the proposed regulations, a description of which follows, and two commentators suggested similar approaches.

Explanation of Provisions

After carefully considering the comments, the Treasury and the Internal Revenue Service have determined that a test based on what constitutes a material limitation would prove too complex and would be administratively burdensome. For this reason, the proposed regulations eliminate the concept of materiality and, instead, establish rules providing that only administration expenses of a certain character which are charged to the marital property will reduce the value of the property for marital deduction purposes. It is anticipated that these rules will have uni-

form application to all estates, will be simple to administer, and will reflect the economic realities of estate administration. These same rules will also apply for purposes of the estate tax charitable deduction.

Under the proposed regulations, a reduction is made to the date of death value of the property interest which passes from the decedent to the surviving spouse (or to a charitable organization described in section 2055) for the dollar amount of any estate transmission expenses incurred during the administration of the decedent's estate and charged to the property interest. Such a reduction is proper because these expenses would not have been incurred but for the decedent's death. No reduction is made for estate management expenses incurred with respect to the property and charged to the property because these expenses would have been incurred even if the death had not occurred. However, a reduction is made for estate management expenses charged to the marital property interest passing to the surviving spouse if the expenses were incurred in connection with property passing to someone other than the surviving spouse and a person other than the surviving spouse is entitled to the income from that property. Estate transmission expenses are all estate administration expenses that are not estate management expenses and include expenses incurred in collecting estate assets, paying debts, estate and inheritance taxes, and distributing the decedent's property. Estate management expenses are expenses incurred in connection with the investment of the estate assets and with their preservation and maintenance during the period of administration.

Proposed Effective Date

These regulations are proposed to be effective for estates of decedents dying on or after the date the regulations are published in the **Federal Register** as final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also

has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the 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 written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for April 21, 1999, beginning at 10 a.m. in Room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by March 31, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Deborah Ryan, Office of

the Assistant Chief Counsel (Pass-throughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 20 is proposed to be amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. In §20.2055-1, paragraph (d)(6) is added to read as follows:

§20.2055-1 Deduction for transfers for public, charitable, and religious uses; in general.

* * * * *

(d) * * *

(6) For the effect of certain administration expenses on the valuation of transfers for charitable deduction purposes, see §20.2056(b)-4(e). The rules provided in that section apply for purposes of both the marital and charitable deductions. This paragraph (d)(6) is effective for estates of decedents dying on or after the date these regulations are published in the **Federal Register** as final regulations.

Par. 3. Section 20.2056(b)-4 is amended by:

1. Removing the last two sentences of paragraph (a).

2. Adding paragraph (e).

The addition reads as follows:

§20.2056(b)-4 Marital deduction; valuation of interest passing to surviving spouse.

* * * * *

(e) *Effect of certain administration expenses*—(1) *Estate transmission expenses*. For purposes of determining the marital deduction, the value of any deductible property interest which passed from the decedent to the surviving spouse shall be reduced by the amount of estate transmission expenses incurred during the

administration of the decedent's estate and paid from the principal of the property interest or the income produced by the property interest. For purposes of this subsection, the term estate transmission expenses means all estate administration expenses that are not estate management expenses (as defined in paragraph (e)(2) of this section). Estate transmission expenses include expenses incurred in the collection of the decedent's assets, the payment of the decedent's debts and death taxes, and the distribution of the decedent's property to those who are entitled to receive it. Examples of these expenses include executor commissions and attorney fees (except to the extent specifically related to investment, preservation, and maintenance of the assets), probate fees, expenses incurred in construction proceedings and defending against will contests, and appraisal fees.

(2) *Estate management expenses*—(i) *In general*. For purposes of determining the marital deduction, the value of any deductible property interest which passed from the decedent to the surviving spouse shall not be reduced by the amount of estate management expenses incurred in connection with the property interest during the administration of the decedent's estate and paid from the principal of the property interest or the income produced by the property interest. For marital deduction purposes, the value of any deductible property interest which passed from the decedent to the surviving spouse shall be reduced by the amount of any estate management expenses incurred in connection with property that passed to a beneficiary other than the surviving spouse if a beneficiary other than the surviving spouse is entitled to the income from the property and the expenses are charged to the deductible property interest which passed to the surviving spouse. For purposes of this subsection, the term estate management expenses means expenses incurred in connection with the investment of the estate assets and with their preservation and maintenance during the period of administration. Examples of these expenses include investment advisory fees, stock brokerage commissions, custodial fees, and interest.

(ii) *Special rule where estate management expenses are deducted on the federal estate tax return*. For purposes of de-

termining the marital deduction, the value of the deductible property interest which passed from the decedent to the surviving spouse is not increased as a result of the decrease in the federal estate tax liability attributable to any estate management expenses that are deducted as expenses of administration under section 2053 on the federal estate tax return.

(3) *Examples.* The following examples illustrate the application of this paragraph (e). In each example, the decedent, who dies after 2006, makes a bequest of shares of ABC Corporation stock to the decedent's child. The bequest provides that the child is to receive the income from the shares from the date of the decedent's death. The value of the bequeathed shares, on the decedent's date of death, is \$3,000,000. The residue of the estate is bequeathed to a trust which satisfies the requirements of section 2056(b)(7) as qualified terminable interest property. The value of the residue, on the decedent's date of death, before the payment of administration expenses and estate taxes, is \$6,000,000. Under applicable local law, the executor has the discretion to pay administration expenses from the income or principal of the residuary estate. All estate taxes are to be paid from the residue. The state estate tax equals the state tax credit available under section 2011. The examples are as follows:

Example 1. During the period of administration, the estate incurs estate transmission expenses of \$400,000, which the executor charges to the residue. For purposes of determining the marital deduction, the value of the residue is reduced by the federal and state estate taxes and by the estate transmission expenses. If the transmission expenses are deducted on the federal estate tax return, the marital deduction is \$3,500,000 (\$6,000,000 minus \$400,000 transmission expenses and minus \$2,100,000 federal and state estate taxes). If the transmission expenses are deducted on the estate's income tax return rather than on the estate tax return, the marital deduction is \$3,011,111 (\$6,000,000 minus \$400,000 transmission expenses and minus \$2,588,889 federal and state estate taxes).

Example 2. During the period of administration, the estate incurs estate management expenses of \$400,000 in connection with the residue property passing for the benefit of the spouse. The executor charges these management expenses to the residue. For purposes of determining the marital deduction, the value of the residue is reduced by the federal and state estate taxes but is not reduced by the estate management expenses. If the management expenses are deducted on the estate's income tax return, the marital deduction is \$3,900,000 (\$6,000,000 minus \$2,100,000 federal and state estate taxes). If the

management expenses are deducted on the estate tax return rather than on the estate's income tax return, the marital deduction remains \$3,900,000, even though the federal and state estate taxes now total only \$1,880,000. The marital deduction is not increased by the reduction in estate taxes attributable to deducting the management expenses on the federal estate tax return.

Example 3. During the period of administration, the estate incurs estate management expenses of \$400,000 in connection with the bequest of ABC Corporation stock to the decedent's child. The executor charges these management expenses to the residue. For purposes of determining the marital deduction, the value of the residue is reduced by the federal and state estate taxes and by the management expenses. The management expenses reduce the value of the residue because they are charged to the property passing to the spouse even though they were incurred with respect to stock passing to the child and the spouse is not entitled to the income from the stock during the period of estate administration. If the management expenses are deducted on the estate's income tax return, the marital deduction is \$3,011,111 (\$6,000,000 minus \$400,000 management expenses and minus \$2,588,889 federal and state estate taxes). If the management expenses are deducted on the estate tax return rather than on the estate's income tax return, the marital deduction remains \$3,011,111, even though the federal and state estate taxes now total only \$2,368,889. The marital deduction is not increased by the reduction in estate taxes attributable to deducting the management expenses on the federal estate tax return.

(4) *Effective date.* This paragraph (e) is effective on the date these regulations are published in the Federal Register as final regulations.

Robert E. Wenzel,
*Deputy Commissioner of
Internal Revenue.*

(Filed by the Office of the Federal Register on December 15, 1998, 8:45 a.m., and published in the issue of the Federal Register for December 16, 1998 63 F.R. 69248)

Foundations Status of Certain Organizations

Announcement 99-13

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organiza-

tions have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Community Housing Corporation of Arkansas Inc., Little Rock, AR
Community Learning Information Network of Arizona Inc., Phoenix, AZ
Community Learning Services Inc., East Point, GA
Community Legal Service Corporation, Ponchatoula, LA
Community Partnership of Santa Clara County, San Jose, CA
Community Peace, Las Vegas, NV
Community Services Institute of Virginia, Richmond, VA
Community Shares of Idaho Inc., Boise, ID
Community Works Inc., Atlanta, GA
Compass Players Inc., Valrico, FL
Compassion Community Living Home Inc., New Orleans, LA
Comprehensive AIDS Resource and Educational Services Inc., Delray Beach, FL
Compulsive Gambling Therapy Center Inc., Worcester, MA
Computer and Multimedia Education Corporation, Williamsburg, VA
Computer Education Management Association, American Fork, UT
Concerned About You Committee Inc., Denver, CO
Concerned African American Men Women, Chicago, IL
Concerned Black Men of New York City Incorporated, New York, NY
Concerned Christians for America, Catharpin, VA
Concerned Citizens for Public Education, Gastonia, NC
Concord Village Resident Management Corporation, Indianapolis, IN
Concordia Neighborhood Association, Portland, OR
Congregations United for Community Action Inc., St. Petersburg, FL
Connecticut Sober Sports League Inc., Waterbury, CT
Conservatory of Performing Arts Inc., Boynton Beach, FL

Consumer Council a Non-Profit Social Service Corporation, Scottsdale, AZ
 Consumer Credit Counseling Service of Mid Missouri, Columbia, MO
 Consumer Financial Education Foundation, Buffalo Grove, IL
 Contemporary Home Health Services a New Jersey Nonprofit Corporation, Woodbury, NJ
 Conway P C User Group Inc., Conway, AR
 Coon Rapids Lions Foundation, Coon Rapids, MN
 Cooperative Planning Coalition, Kalispell, MT
 Coordinating Committee in Support of the All Amhara Peoples, Boston, MA
 Cops Cons and Kids Inc., Newark, NJ
 Cops for Christ Mohoning Valley Ohio, Youngstown, OH
 Corey Lewis Foundation Inc., Boca Raton, FL
 Cornerstone Childrens Home Inc., Nederland, TX
 Cornerstone Development Center Inc., Birmingham, AL
 Cornerstone Prison Ministries Inc., Garland, TX
 Cornerstone Steppington Inc., Columbia, MD
 Cornerstone Windridge Inc., Columbia, MD
 Corporation for Public Education in American Popular Music, Bethesda, MD
 Corpus Christi Wheelchair Tennis Club, Corpus Christi, TX
 Cotter-Lane Active Parent Support Group Inc., Louisville, KY
 Cottondale Dixie Youth Baseball Incorporated, Cottondale, AL
 Counsel for Property Rights Foundation Inc., Washington, DC
 Council for Rural Health Clinic Resources and Education, Cuero, TX
 Council of Baptist Pastors Community Development Corporation, Detroit, MI
 Council of United Jewish Orthodox Organization of Rockland County NY, Monsey, NY
 Court Appointed Special Advocates of Hill County Inc., Hillsboro, TX
 Courthouse Restoration 3-28-93 Inc., Hillsboro, TX
 Courtland Historical Foundation, Courtland, AL
 CPAA Concerned Parents for Academics-Athletics, Waddell, AZ
 Crater AIDS Action Program, Petersburg, VA
 Created Families Inc., Denver, CO
 Creative Educational Concepts, Denver, CO
 Creative Maintenance Emergency Shelter & Affordable Housing, Long Beach, CA
 Creative Outreach Inc., Conroe, TX
 Creative Youth Incorporated, Atlanta, GA
 Creek County Civil Emergency Management Volunteers, Sapulpa, OK
 Creekside Community Development Corporation, Detroit, MI
 Crestwood Education Foundation, Mantua, OH
 Creswell Athletic Association Inc., Creswell, NC
 Crime Control Education Foundation, Palm Springs, CA
 Crises Press Inc., Gainesville, FL
 Crisis Pregnancy Center Inc., Springfield, MA
 Cross Management Properties, Columbus, OH
 Crosscreek Apartments Inc., Whitfield, MS
 Crosslinks Ministries, Strongsville, OH
 Crossroads Pregnancy Resource Center of Gunnison Valley a Nonpro, Gunnison, CO
 Crosswalk Ministries Inc., Ocala, FL
 Cubbs Citizens United for a Better Balch Springs, Balch Springs, TX
 Culinary Arts Plus, Plano, TX
 Cultural Alliance Through Art Inc., Montvale, NJ
 Cultural Diversity Educational Association, Detroit, MI
 Cultural Initiatives Inc., Eagan, MN
 Culture Awareness Inc., Philadelphia, PA
 Culture Kids Project Inc., Adelphi, MD
 Culture Without Borders Inc., New York, NY
 Cumberland Plateau Services Inc., Sewanee, TN
 Cuney Homes Management Corporation, Houston, TX
 Cy-Fair Preservation Society Incorporated, Houston, TX
 Czech American Summer Music Institute Inc., Tallahassee, FL
 M & M Community Development Inc., Columbus, OH
 M C Escher Museum Foundation, Santa Cruz, CA
 M C H Inc., Naperville, IL
 M O S A I C, Roseville, MI
 M Power Inc., Minneapolis, MN
 Maaleh Adumim Foundation Inc., New York, NY
 MacArthur Blue Guard Alumni Association, San Antonio, TX
 Macon County Education Support System Inc., Tuskegee, AL
 Madison Community Free Clinic Inc., Marshall, NC
 Madison Avenue Development Corporation, Baltimore, MD
 M & M Ministries, Presque Isle, ME
 Madison Lions Foundation Inc., Madison, CT
 Magdalena School Parent Group, Magdalena, NM
 Magellan Theatre, Chicago, IL
 Magellan University, Tucson, AZ
 Magnolia Heritage Charities Inc., Green Cove Springs, FL
 Mahogany House for Young Women Inc., Phoenix, AZ
 Main Street Business Resource & Development Inc., Hartford, CT
 Main Street Gym Inc., Salisbury, MD
 Main Street Kids Inc., Canton, KS
 Maine Studies Foundation Inc., Standish, ME
 Mainstreet Seymour Indiana Inc., Seymour, IN
 Makah Resident Initiatives Program, Neah Bay, WA
 Make a Dent Foundation Inc., Chicago, IL
 Make It Home, Houston, TX
 Making a Better Tomorrow Inc., Wichita, KS
 Making a Difference Ministries, Temple, TX
 Making Good Foundation Inc., Marietta, GA
 Making Life Easier Inc., Tigard, OR
 Malemte Football Booster Club, Fairbanks, AK
 Maloney-Wilding Foundation for Children & Teens, Escondido, CA
 Management Research Foundation Inc., Boca Raton, FL
 Manahata Pan American Indian Arts Council Inc., New York, NY
 Manatee Catholic School Foundation, Bradenton, FL
 Manchester High School Alumni Association, Manchester, CT
 Manchester Summerstage Incorporated, Manchester, MA
 Manitowoc County Ice Center Inc., Manitowoc, WI

Manjiro Society for International Exchange Inc., McLean, VA

Many Are Called-Few Are Chosen Ministries Inc MAC-FAC MINISTRIES, Houston, TX

Maple Valley Child Care Center, Vermontville, MI

Marguerite Rawalt Legal Defense Fund, Washington, DC

Maricopa Foundation for Affordable Housing, Phoenix, AZ

Mark Evans Production Group Inc., Winooski, VT

Mark Fuqua Ministries Inc., Fort Worth, TX

Marketplace Ministry, Grand Rapids, MI

Marmet Soccer Association Inc., Charleston, WV

Marrero Community Development Corporation, Marrero, LA

Mars Hill Ministries Inc., Miami Beach, FL

Martin de Porres Foundation, Aurora, IL

Martin Luther King Drive Resident Organization, Chicago, IL

Martin Luther Memorial Homes Foundation, Holt, MI

Martin Youth Foundation, Joliet, IL

Martinsville-Henry County Music Association Inc., Martinsville, VA

Mary I Minor Scholarship Fund, Washington, DC

Maryiann Sitton Ministries Inc., Hamilton, MT

Marys Love Kingdom Inc., Philadelphia, PA

Mason County Little League Football Inc., Maysville, KY

Massachusetts Guongdong Committee Inc., Boston, MA

Massachusetts Save James Bay Foundation Inc., Boston, MA

Masters Review Inc., New York, NY

Masters Touch, Vacaville, CA

Mattoon Youth Sports League Inc., Mattoon, IL

Maude Ellen Coats Armstrong MECA Foundation, Norfolk, VA

Mayors Youth Center Inc., Granite City, IL

Maysville Better Community Action Org Inc., Maysville, NC

MB Educational Programs Inc., Chippewa Falls, WI

McBride Volunteer Fire Department Ladies Auxiliary, Kingston, OK

McConnells Mill Preservation Association, Portersville, PA

McCook Legion Baseball Boosters Inc., McCook, NE

McCoy Center for the Arts Inc., Birmingham, AL

McDonalds Avail, Poway, CA

McDowell County Animal Aid Inc., Marion, NC

McHenry County Gang Drug Task Force, Woodstock, IL

McMillan Ministries, Homerville, GA

NcNair Group Home Inc., Modesto, CA

McRae Berry Youth Camp Inc., Hampton, AR

Meacham Park Resident Council, St. Louis, MO

Medassist International, Buffalo, NY

Media Partnership for Jobs, Detroit, MI

Medica International Inc., McKinney, TX

Medical Airlift Volunteers Inc., Clayton, MO

Medjugorje Appeal Inc., Cranston, RI

Melissa Segars Foundation, Fayetteville, GA

Melody Music Education Listening and Outreach for District Youth, Washington, DC

Men Against Creating Hostilities and Appression Macho, Denver, CO

Men of Action Inc., Washington, DC

Mens Council of Austin, Austin, TX

Mens Grief Support Group, Salt Lake City, UT

Mental Health Association in Putnam County II Inc., Brewster, NY

Mental Health Association of Clayton County, Morrow, GA

Mercy & Truth Prison Ministry Inc., Carbon Hill, AL

Mercy International America Inc., New York, NY

Meridzo Center, Franklin, OH

Merriday Center for Inclusion in the Classroom Inc., Orlando, FL

Merry Thought Foundation Inc., Annapolis, MD

Messengers of Mary Inc., Lexington, KY

Metro Atlanta Stroke Council, Atlanta, GA

Metro Magazine on WNYE-TV Inc., Long Island City, NY

Metropolitan Contributions for Life Inc., Houston, TX

Mexican American Community Development Organization, Dallas, TX

Mexican Cultural Center of Northern California, Rancho Cordova, CA

Meyir America Inc., Wall, NJ

Miami Valley Housing Association I Inc., Dayton, OH

Miami Valley Tree Source Inc., Miamisburg, OH

Micheaux Foundation, Washington, DC

Michigan Hemingway Society, Petoskey, MI

Mid-America Cancer Rehabilitation Organization Inc., Evansville, IN

Mid-Atlantic Youth Sports and Educational Expo Inc., East Orange, NJ

Mid-Coast Compeer Inc., Rockland, ME

Mid-County Teachers Credit Union Scholarship Foundation Inc., Port Neches, TX

Mid-Houston Valley Chapter of the Spina Bifida Assoc. of America Inc., Newburgh, NY

Mid-Ohio Resource Center Inc., Grove City, OH

Mid-South Mens Council Inc., Memphis, TN

Middle Path Foundation Inc., New York, NY

Middle Tennessee Grand Championship Inc., Nashville, TN

Midnight Basketball of Northeast Ohio, Canton, OH

Midway Club of Kansas, Great Bend, KS

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

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 ap-

plies 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. Proc.—Revenue Ruling.

S—Subsidiary.

S.P.R.—Statements of Procedural Rules.

Stat.—Statutes at Large.

T—Target Corporation.

T.C.—Tax Court.

T.D.—Treasury Decision.

TFE—Transferee.

TFR—Transferor.

T.I.R.—Technical Information Release.

TP—Taxpayer.

TR—Trust.

TT—Trustee.

U.S.C.—United States Code.

X—Corporation.

Y—Corporation.

Z—Corporation.

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