WHAT'S NEW SUPPLEMENT

December 19, 2001

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2001 Workbook

CONTENTS

CORRECTIONS TO 2001 *FARM INCOME TAX WORKBOOK*

Page 23. After the three bullets at the bottom of the page, add the following. “The statute of limitations will be suspended for the period that the IRS is prohibited, by I.R.C. §6331(k), from levying on the tax-payer's property. However, the Community Renewal Tax Relief Act of 2000 (signed on December 21, 2000) includes a number of “technical corrections” to previously enacted tax legislation, including RRA of 1998. I.R.C. §6331(k) was changed so that as of December 21, 2000, the statute of limitations for collection is **not** suspended during the time that an offer is pending or considered pending.”

Page 24. Replace the first three bullets with the following:

- For any time prior to the acceptance of the offer
- For one year after rejection of the offer

Page 70. Replace the last sentence on the page with the following. "If Merle and Linda pay points at closing they cannot deduct them in the year paid because they are not using the loan to purchase or remodel a personal residence. [Treas. Reg. §1.163-10T(j)(2)(i)]. The points can be amortized over the life of the loan."

Page 71. Replace last sentence before Form 1041 with the following. "If Linda paid the interest before her death, the interest could be deducted on her final return [I.R.C. §163(h)(3)(A)]."

Page 112. In the second line of Answer 2 at the top of the page, "1997 through 1999" should be "1998 through 2000."

Page 116. In the first line of last paragraph, "1990" should be "1991."

Page 130. The fourth line on the page should read "Line 6a," not "Line 6a and 6b."

Page 135. The 2000 Schedule F should be a 2001 Schedule F.

Page 136. The 2000 Form 4835 should be a 2001 Form 4835.

Page 142. In the second full paragraph, "WRP" should be "EWP."

Page 158. In the second sentence of the Practitioner Note, add "If" at beginning of sentence and add a comma after "months."

Page 167. In the first sentence under the heading "Taxable Bonds Bought at a Premium," omit the words "becomes taxable" at the end of the first line.

Page 173. In the fourth line of the table in Example 1, "500 shares" should be "1,000 shares."

Page 180. Add **McData** after .24379 sh. on line 8, column a of the Schedule D.

Page 185. Add **QQQs** after 250 sh. on line 1, column a of the Schedule D.

Page 234. The three figures reported in column (b) of Part IV of Form 4797 should be reported in column (a).

Page 240. On line 22, under Property D, "49,563" should be "50,437."

Page 244. In Answer 1, John Jr.'s basis should be $100,000, not $125,000. The total basis should be $125,000, not $150,000, and John Jr.'s taxable gain should be $35,000, not $10,000.

Page 253. In the table showing additional withholding, the amount for Semimonthly should be $16.60 and the amount for Monthly should be $33.10.

Page 259. On line 17 in the last column, "1,091" should be "0."

Page 260. On line 2 in column C, "9,564" should be "12,400."

Page 262. On lines 22 and 23, "3,814" should be "2,814."

Page 267. In the fourth line of Answer 3 in the middle of the page, "$5,450" should be "$4,550."

Page 298. In the last sentence of the Practitioner Caution near the top of the page, change "1986" to "1996."

Page 302. In the Practitioner Note at the bottom of the page, "page 311" in the first line should be "page 307." In the second line of item c, "$36,000" should be "$36,100."

Page 307. In the footnote at the bottom of the page, "page 306" should be "page 302."

Page 309. At the top of the page, add "Answer 1-Regulation Ignored." Omit "150,000" on line 6. Add another Form 8582 with "Answer 2-Regulation followed" above it and filled out as follows. "Line 1b: (69,000); Line 1d: (69,000); Line 3: (69,000); Line 4: 69,000; Line 5: 150,000; Line 6: 260,000; Line 9: 0; Line 10: 0; Line 11: 0."

Page 324. In the facts for the Example add, "The executor of Myron's estate did **not** elect to include the $14,159.20 of deferred E bond interest on Myron's final 1994 Form 1040."

Page 337. In the bottom left box of the chart at the top of the page, change "May" to "March."

Page 389. In the Practitioner Note in the first column, "page 488" in the last sentence should be "page 486."

Page 469. On the second line, "Act §134" should be "Act §314(c)."

Page 469. In the second line of the second paragraph of Example 1, "increase his basis to $55,000" should be "increase his basis to $75,000."

Page 479. In the second line from the bottom, "line 50" should be "line 47."

Page 489. The standard deduction in Example 2 (which begins on page 488) and in Example 3 should be $6,650—the head of household rate for 2001. That changes taxable income in Example 2 to $4,650 and the tax liability to $697. In the second sentence after the table at the top of the page, "$1,035" should be "$697." In the second sentence of the second paragraph, "$1,000" should be "$503" and "$200" should be "$697." Taxable income in Example 3 is changed to $1,750 and the tax liability is changed to $263. In the second sentence after the table, "$600" is changed to "$263." In the last sentence of Example 3, "$1,600" is changed to "$1,263" and "$600" is changed to "$263."

Page 490. In the fourth item under Timing of Credit in the middle of the page, "special needs" should be "foreign." In the Practitioner Note that follows, "special needs" should be "foreign." See I.R.C. §137(e) and Notice 97-9, part H(1) and (2) and part J, Example 1.

Page 490. The Practitioner Note at the bottom of the page and the sentence before it apply only to foreign adoptions.

Page 491. In the table at the bottom of the page, the second column of the fourth line should be "Yes." For 2000 and 2001, the credit is allowed against the AMT. I.R.C. §26(a)(2).

Page 496. In the seventh line from the bottom of the page, "%5" should be "5%."

Page 499. In the third paragraph, first line, "May 30" should be "May 31." In the third line of Example 4, "May 30, 2003" should be "May 31, 2003."

Page 500. In the fourth paragraph, "show" in the first line should be "she" so that the phrase reads "Melissa would minimize the taxes she owes…"

Page 500. In the line above the Practitioner Note, "fall" should be "full."

Page 500. In the third line from the bottom, ".10" should be ".15." In the second line from the bottom, "$32" should be "$48." In the bottom line, "$586" should be "$602."

Page 502. The last sentence under the heading Rollovers for Benefit of Same Beneficiary should be replaced with the following sentence. "This rollover treatment applies to only one such transfer within a 12-month period [I.R.C. §529(c)(3)(c)(iii)]."

Page 503. In the first line of the first table, "All but MFJ" should be "All but MFJ and MFS" and "$30,000" should be "$40,000."

Page 504. In Example 2 beginning at the bottom of the page, the contribution limit for 2001 should be 13.0435% rather than 15% and the contribution limit for 2002 should be 20% rather than 25% since Sharon is self-employed. The following changes should be made to the table on the top of page 505. In the fifth line, ".15" should be ".130435." In the sixth line, "$12,476" should be "$10,849." In the sentence following that table, "$12,476" should be "$10,849" and "$1,976" should be "$349." In the second table on page 505, ".25" in the sixth line should be ".20," "$20,669" in the seventh line should be "$16,535," and "$31,669" in the eighth line should be "$27,535."

Page 515. In the last line of Example 5, "$323,092" should be "$327,593."

Page 539. In Example 5, "2001" in the third line should be "2000." In paragraph 2 just after the Single Life Expectancy table, "2000" in the second line should be "2001."

Page 540. In the third line of item #3 near the top of the page, "$11,063" should be "$10,973."

Page 563. At the bottom of the page, the divisor of the fraction should be "17.4" instead of "23.5."

Page 565. In the second fraction after the Practitioner Note, the divisor should be "23.5" instead of "17.7."

Page 571. The table omits age 80 and erroneously reports the distribution period for age 80 as the distribution period for age 79. The distribution period for age 79 should be 18.4. The distribution period for age 80 is 17.6.

Page 576. At the beginning of the third line under Background near the top of the page, "more than two" should be "no more than two."

Page 587. In the second line of the table near the top of the page, "(14,440)" in the second line of the third column should be "(14,400)" and "($4,440)" in the third line should be "($4,400)."

Page 594. Omit the two paragraphs above the heading "Agreement Patterns for the Retirement of an Owner." They are the same as the Practitioner Note at the bottom of page 591.

Page 687. The heading "Tax Rates for 2000" should be "Tax Rates for 2001."

UPDATES TO 2001 *FARM INCOME TAX WORKBOOK*

Page 103. Share Rent Landowners

The instructions for the 2001 Schedule J (Form 1040) include Form 4835 in the list of forms on which farm income and expenses are “generally reported.” This addition to the list indicates that the IRS will treat share rent income as electible farm income.

Page 189. Issue 8: New 8% and 18% Capital Gain Rates

The Taxpayer Relied Act of 1997 includes assets used in a trade or business in the property for which taxpayers can make the mark to market election. See Taxpayer Relief Act of 1997 §311(e)(1)(B). Therefore, taxpayers can apparently acquire a new depreciable basis in assets used in the trade or business by making the mark to market election for that property. Gain that is recognized as a result of the election is not included in self-employment income. Depreciation of the new basis would reduce both ordinary taxable income and self-employment income.

Page 478. Income Tax Rate Structure

The 2001 Act did not allow dependents to receive a rebate check or the credit for the 10% bracket on their 2001 tax return. However, in a letter to the Treasury Department, Senate Finance Committee Chairman Max Baucus (D-MT), Ranking Member Chuck Grassley (R-IA), and House Ways and Means Chairman Bill Thomas (R-CA) clarified that in enacting the 2001 Act, Congress intended the new 10% bracket to apply to all individuals for 2001. They instructed the IRS to draft tax forms reflecting that intent.

Consequently, the instructions for Form 1040 and Form 1040A allow dependents to get the benefit of the 10% tax rate. The benefit is realized by using the following worksheet to compute the taxes that are reported on line 40 of Form 1040 or on line 46 of Form 1040A.

Tax Computation Worksheet for Certain Dependents —Line 40 *Keep for Your Records*

Before you begin:

√ Be sure you can use this worksheet (see **Tax Computation Worksheet for Certain Dependents** above).

√ **Do not** use this worksheet if you, or your spouse if filing jointly, received (before offset) an advance payment of your 2001 taxes.

√ Be sure you read the **Special Rules** below.

1. Figure the tax on the amount on Form 1040, line 39 (or the applicable line of the worksheet, schedule, or form listed below). Use the Tax Table or Tax Rate Schedules, whichever applies . . . . . . **1.** ______

2. Is the amount on line 1 more than the amount shown below for your filing status?

- Single or married filing separately—$900
- Married filing jointly or qualifying widow(er)—$1,800
- Head of household—$1,500

☐ **Yes.** Enter: $300 if single or married filing separately; $500 if head of household; $600 if married filing jointly or qualifying widow(er).

☐ **No.** Divide the amount on line 1 by 3.0. . . . . **2.** ______

3. Subtract line 2 from line 1. Enter the result here and on Form 1040, line 40 (or the applicable line of the worksheet, schedule, or form listed below) . . . . **3.** ______

Special Rules. If you use:

- The **Capital Gain Tax Worksheet** on page 34, use the worksheet above to figure the tax on lines 4 and 14 of the Capital Gain Tax Worksheet.
- **Schedule D, Part IV,** use the worksheet above to figure the tax on lines 25 and 39 of Part IV. If you use the **Schedule D Tax Worksheet** on page D-9, use the worksheet above to figure the tax on lines 15 and 36 of the Schedule D Tax Worksheet.
- **Schedule J,** use the worksheet above to figure the tax on line 4 of Schedule J.
- **Form 8615,** use the worksheet above to figure the tax on lines 15 and 17 of Form 8615 (and line 9 if the parent used this worksheet).
- **Other forms or worksheets** that require you to figure the tax using the 2001 Tax Table or Tax Rate Schedules, use the worksheet above to figure the tax on any line that would otherwise be figured using the 2001 Tax Table or Tax Rate Schedules.

Page 687 The tax brackets for 2002 are as follows:

TABLE 1
I.R.C. §1(a).
MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES

If Taxable Income Is:	The Tax Is:
Not over $12,000	10% of the taxable income
Over $12,000 but not over $46,700	$1,200 plus 15% of excess over $12,000
Over $46,700 but not over $112,850	$6,405 plus 27% of excess over $46,700
Over $112,850 but not over $171,950	$24,265.50 plus 30% of excess over $112,850
Over $171,950 but not over $307,050	$41,995.50 plus 35% of excess over $171,950
Over $307,050	$89,280.50 plus 38.6% of excess over $307,050

TABLE 2
I.R.C. §1(b)
HEADS OF HOUSEHOLDS

If Taxable Income Is:	The Tax Is:
Not over $10,000	10% of the taxable income
Over $10,000 but not over $37,450	$1,000 plus 15% of excess over $10,000
Over $37,450 but not over $96,700	$5,117.50 plus 27% of the excess over $37,450
Over $96,700 but not over $156,600	$21,115 plus 30% of the excess over $96,700
Over $156,600 but not over $307,050	$39,085 plus 35% of the excess over $156,600
Over $307,050	$91,742.50 plus 38.6% of excess over $307,050

TABLE 3
I.R.C. §1(c).
UNMARRIED INDIVIDUALS
(OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

If Taxable Income Is:	The Tax Is:
Not over $6,000	10% of the taxable income
Over $6,000 but not over $27,950	$600.00 plus 15% of excess over $6,000
Over $27,950 but not over $67,700	$3,892.50 plus 27% of the excess over $27,950
Over $67,700 but not over $141,250	$14,625 plus 30% of the excess over $67,700
Over $141,250 but not over $307,050	$36,690 plus 35% of the excess over $141,250
Over $307,050	$94,720 plus 38.6% of excess over $307,050

TABLE 4
I.R.C. §1(d).
MARRIED INDIVIDUALS FILING SEPARATE RETURNS

If Taxable Income Is:	The Tax Is:
Not over $6,000	10% of the taxable income
Over $6,000 but not over $23,350	$600.00 plus 15% of excess over $6,000
Over $23,350 but not over $56,425	$3,202.50 plus 27% of the excess over $23,350
Over $56,425 but not over $85,975	$12,132.75 plus 30% of the excess over $56,425
Over $85,975 but not over $153,525	$20,997.75 plus 35% of the excess over $85,975
Over $153,525	$44,640.25 plus 38.6% of excess over $153,525

TABLE 5
I.R.C. §1(e).
ESTATES AND TRUSTS

If Taxable Income Is:	The Tax Is:
Not over $1,850	15% of the taxable income
Over $1,850 but not over $4,400	$277.50 plus 27% of excess over $1,850
Over $4,400 but not over $6,750	$966.00 plus 30% of the excess over $4,400
Over $6,750 but not over $9,200	$1,671.00 plus 35% of the excess over $6,750
Over $9,200	$2,528.50 plus 38.6% of the excess over $9,200

Page 689 The 2002 rates are as follows:

Standard Deductions	
Joint or Qualifying Widow(er)	$7,850
Single	4,700
Head of Household	6,900
Married Filing Separately	3,925
Additional for Elderly/Blind—Married	900
Additional for Elderly/Blind—Unmarried	1,150
Taxpayer Claimed as Dependent	750
Personal and Dependent Exemption Deduction	**$3,000**
Unearned Income Without Kiddie Tax	**$1,500**
Beginning/Ending of Personal Exemption Phaseout Range—Based on AGI	
Joint or Qualifying Widow(er)	$206,000/328,500
Single	137,300/259,800
Head of Household	171,650/294,150
Married Filing Separately	103,000/164,250
Beginning of Itemized Deduction Phaseout Range—Based on AGI	
Joint, Single, Head of Household	$137,300
Married Filing Separately	68,650
FICA/SE Tax Information	
OASDI Tax Maximum Earnings	$84,900
FICA (OASDI and HI) Tax Rate (Employee)	0 7.65%
SE Tax Rate	15.3%
Maximum Deductible 401(k) and 403(b) Employee Contribution	**$11,000**
Self-Employed Health Insurance Deduction	**70%**
Estimated Tax Payments (AGI>$150,000)	
Prior Year Tax % or	112%
Current Year Tax %	90%
Earnings Ceiling for Social Security	
Below Age 65	$11,280
Earnings Required to Earn One Quarter of Coverage	**$870**
Gift and Estate Tax Applicable Exclusion Amount	**$1,000,000**
Gift Tax Annual Exclusion	**$11,000**
Section 179 Deduction	**$24,000**

Page 691. The interest rate for underpayment and overpayment of taxes by non-corporate taxpayers for the quarter beginning January 1, 2002 is 6%—a 1% decrease from the previous quarter.

Page 694. Applicable Federal Rates for November and December 2001:

	NOVEMBER 2001 Period for Compounding			
	Annual	**Semiannual**	**Quarterly**	**Monthly**
Short-term AFR	2.73%	2.71%	2.70%	2.69%
Mid-term AFR	4.13%	4.09%	4.07%	4.06%
Long-term AFR	5.31%	5.24%	5.21%	5.18%

[Rev. Rul. 2001-52, 2001-45 IRB 434]

	DECEMBER 2001 Period for Compounding			
	Annual	**Semiannual**	**Quarterly**	**Monthly**
Short-term AFR	2.48%	2.46%	2.45%	2.45%
Mid-term AFR	3.97%	3.93%	3.91%	3.90%
Long-term AFR	5.05%	4.99%	4.96%	4.94%

[Rev. Rul. 2001-58, 2001-50 IRB ___]

Page 695

Auto Standard Mileage Allowance for 2002

Business	36.5 cents per mile
Charitable	14.0 cents per mile
Medical/Moving	13.0 cents per mile

Excise Tax on Luxury Cars for 2002

Floor for Application of Tax Rate	$40,000
Rate of Tax	3%

ACCOUNTING

Notice 2001-76
I.R.C. §446]

☞ **Relief from accrual accounting is extended to taxpayers with gross receipts of less than $10 million.**

Pursuant to the discretion granted the Commissioner of Internal Revenue under I.R.C. §§446 and 471, this notice provides a proposed revenue procedure that will allow qualifying small business taxpayers with gross receipts of less than $10 million to use the cash receipts and disbursements method of accounting as described in the proposed revenue procedure with respect to eligible trades or businesses. This proposed revenue procedure is intended to reduce the administrative and tax compliance burdens on certain small business taxpayers and to minimize disputes between the IRS and these taxpayers regarding the requirement to use an accrual method of accounting under I.R.C. §446 because of the requirement to account for inventories under I.R.C. §471. Although this revenue procedure is being issued in proposed form, taxpayers may rely on it for taxable years ending on or after December 31, 2001.

The IRS believes that I.R.C. §263A will have limited applicability to resellers and producers with gross receipts of $10,000,000 or less because of the exception for resellers in I.R.C. §263A(b)(2)(B) and the indirect cost exception for producers in Treas. Reg. §1.263A-2(b)(3)(iv). However, the IRS requests comments on any additional relief that should be considered for taxpayers with gross receipts of $10,000,000 or less to relieve any administrative burden of I.R.C. §263A. The IRS also welcomes other comments on the proposed revenue procedure provided in this notice. Comments should be submitted by March 1, 2002, either to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
Attn: CC:PA:T:CRU (ITA)
Room 5529

or electronically via the IRS internet site at: Notice.Comments@m1.irscounsel.treas.gov (the Service Comments e-mail address).

[Notice 2001-76, 2001-52 IRB ___]

BASIS

AOD 2001-006 (October 19, 2001)
[I.R.C. §2040]

☞ **IRS agrees that surviving spouse gets a full date-of-death value basis in joint tenancy property that was acquired by decedent spouse before 1977.**

Issue. Whether I.R.C. §2040(b)(1) applies to joint interests created before January 1, 1977, where the deceased joint tenant died after December 31, 1981.

Discussion. John P. Hahn signed a subscription agreement to purchase shares of a co-op apartment in 1972 for $44,000. In 1973 these shares were issued to John and his wife Therese as joint tenants with right of survivorship. Mrs. Hahn became the sole owner of the shares upon Mr. Hahn's death in 1991. One hundred percent of the value of the shares on the date of Mr. Hahn's death ($700,000) was reported on Mr. Hahn's federal estate tax return as the value of his interest in the shares.

In 1993, Mrs. Hahn sold the shares for $720,000. On her 1993 federal income tax return, she reported no gain on the sale, having calculated her basis in the shares to equal $758,412 ($700,000 date of death value, plus $58,412 in other adjustments). The IRS determined that Mrs. Hahn could receive a stepped-up basis for only fifty percent of the date of death value of the shares, resulting in a basis of $428,340 composed of the following amounts: one-half of the original cost basis ($22,000), one-half of the date of death value ($350,000), and $56,340 in other adjustments. In a Notice of Deficiency, the IRS determined that Mrs. Hahn had a gain of $166,660 on the sale (after allowing for a one-time exclusion of $125,000 of gain from the sale of a principal residence under I.R.C. §121). Mrs. Hahn filed a petition with the U.S. Tax Court to contest this determination.

Prior to 1977, I.R.C. §2040 provided that the gross estate includes the value of all property held at the time of decedent's death by the decedent and another person in a joint tenancy or tenancy by the entirety, except such part of the entire value that is attributable to the amount of consideration in money or money's worth furnished by such other person. The Tax Reform Act of 1976 added subsection (b) to the statute creating a special rule where the joint tenants were husband and wife. I.R.C. §2040(b)(1) provided that only one-half of the value of a qualified joint interest was includible in the decedent's gross estate, without regard to which spouse furnished the consideration to acquire the jointly held property. I.R.C. §2040(b)(2) provided in part that "qualified joint interest" means an interest in property held by decedent and the decedent's spouse as joint tenants or as tenants by the entirety, but only if the joint interest was created by one or both spouses, and the creation of the joint interest constituted in whole or in part a gift for purposes of chapter 12. The new fifty percent inclusion rule of I.R.C. §2040(b) was applicable to joint interests created after December 31, 1976.

The Economic Recovery Tax Act of 1981 redefined "qualified joint interest" to eliminate the requirement that the creation of the joint interest be treated as a gift. No change was made to I.R.C. §2040(b)(1). The 1981 amendment was applicable to estates of decedents dying after December 31, 1981.

In this case, respondent argued that the 1981 amendment to I.R.C. §2040(b)(2) expressly or impliedly repealed the effective date of I.R.C. §2040(b)(1), and, therefore, the fifty percent inclusion rule was applicable in this case where the decedent died after 1981, even though the joint interest was created prior to 1977.

The Court held that the 1981 amendment did not expressly repeal the effective date of I.R.C. §2040(b)(1), since there is no language in the 1981 amendment that specifically repeals the effective date of subsection (b)(1). The Court also held that the 1981 amendment did not impliedly repeal the effective date of I.R.C. §2040(b)(1), because I.R.C. §2040(b)(1) enacted in 1976 and the 1981 amendment to I.R.C. §2040(b)(2) are not in conflict and are not mutually exclusive. **Accordingly, the Court held that I.R.C. §2040(b)(1) does not apply to spousal joint interests created before January 1, 1977.**

Other courts that have previously examined this issue have reached the same conclusion. See *Patten v. United States*, 116 F.3d 1029 (4th Cir. 1997); *Gallenstein v. United States*, 975 F.2d 286 (6th Cir. 1992); *Baszto v. United States*, 1997 U.S. Dist. LEXIS 17992 (M.D. Fla. 1997); *Wilburn v. United States*, 1997 U.S. Dist. LEXIS 17003 (D. Md. 1997); *Anderson v. United States*, 1996 U.S. Dist. LEXIS 7713 (D. Md. 1996).

Accordingly, the IRS will no longer litigate that I.R.C. §2040(b)(1) applies to joint interests created before January 1, 1977, where the deceased joint tenant died after December 31, 1981.

[Action on Decision 2001-006 (October 19, 2001]

CORPORATIONS, PARTNERSHIPS AND LLCs

Rev. Rul. 2001-50
[I.R.C. §1374]

☞ **S corporation's income from timber, coal, and iron ore is not subject to built-in gains tax.**

Issue. Is the S corporation's recognized gain in each of the situations described below recognized built-in gain for purposes of I.R.C. §1374?

Facts

SITUATION 1: An S corporation holds timber property with built-in gain on the date its election to convert from a C corporation to an S corporation is effective (or acquires timber property with built-in gain from a C corporation in a transaction to which I.R.C. §1374(d)(8) applies). During the 10-year period beginning with the first day of the first taxable year for which the corporation was an S corporation (or beginning on the day of the I.R.C. §1374(d)(8) transaction) (the recognition period) the S corporation cuts the timber and sells the resulting wood products and recognizes that built-in gain in a transaction to which I.R.C. §631 does not apply.

SITUATION 2: An S corporation holds timber property with built-in gain on the date its election to convert from a C corporation to an S corporation is effective (or acquires timber property with built-in gain from a C corporation in a transaction to which I.R.C. §1374(d)(8) applies). During the recognition period, the S corporation recognizes that built-in gain on cutting the timber pursuant to an election under I.R.C. §631(a).

SITUATION 3: An S corporation holds timber property with built-in gain on the date its election to convert from a C corporation to an S corporation is effective (or acquires timber property with built-in gain from a C corporation in a transaction to which I.R.C. §1374(d)(8) applies). During the recognition period, the S corporation recognizes that built-in gain on the disposal of the timber under a contract to which I.R.C. § 631(b) applies.

SITUATION 4: An S corporation holds coal or domestic iron ore property with built-in gain on the date its election to convert from a C corporation to an S corporation is effective (or acquires coal or domestic iron ore property with built-in gain from a C corporation in a transaction to which I.R.C. §1374(d)(8) applies). During the recognition period, the S corporation recognizes that built-in gain on the disposal of the coal or domestic iron ore under a contract to which I.R.C. §631(c) applies.

Law and Analysis

I.R.C. §1374 imposes a corporate-level tax on an S corporation's net recognized built-in gain during the recognition period in the case of a C corporation's conversion to S corporation status [I.R.C. §1374(a)] or an S corporation's acquisition of assets in a transaction in which the S corporation's basis in the acquired assets is determined by reference to the basis of such assets in the hands of a C corporation [I.R.C. §1374(d)(8)]. Recognized built-in gain includes any gain recognized on the disposition of an asset during the recognition period, except to the extent the S corporation establishes that it did not hold the asset on the conversion date or I.R.C. §1374(d)(8) transaction date, or that the gain recognized was greater than the excess of the asset's fair market value over its adjusted basis on the conversion date or I.R.C. §1374(d)(8) transaction date [I.R.C. §1374(d)(3)]. I.R.C. §1374(d)(3) applies to any gain recognized during the recognition period in a transaction treated as a sale or exchange for Federal income tax purposes [Treas. Reg. §1.1374-4(a)]. In Example 1 of Treas. Reg. §1.1374-4(a)(3), X is a C corporation that elects to become an S corporation effective January 1, 1996. On that date, X owns a working interest in an oil and gas property with a fair market value of $250,000 and an adjusted basis of $500,000. During the recognition period, X produces and sells oil extracted from the oil and gas property for $75,000. **The example concludes that the $75,000 is not recognized built-in gain under I.R.C. §1374 because, as of the beginning of the recognition period, X held only a working interest in the oil and gas property, and not the oil itself.**

I.R.C. §631(a) provides that, under certain circumstances, a taxpayer's cutting of timber is treated as a sale or exchange of the timber in the year it is cut. I.R.C. §631(b) provides that, under certain circumstances, a taxpayer's disposition of timber shall be treated as giving rise to gain or loss on a sale of such timber. I.R.C. §631(c) provides that, under certain circumstances, a taxpayer's disposition to unrelated parties of coal or domestic iron ore shall be treated as giving rise to gain or loss on a sale of such coal or iron ore. In general, I.R.C. §631 permits a taxpayer to benefit from capital gain treatment in circumstances that would otherwise give rise to ordinary income.

If an S corporation holds timber property on the date its election to convert from a C corporation to an S corporation is effective and, during the recognition period, cuts the timber and sells the resulting wood products in a transaction to which I.R.C. §631 does not apply, the tax consequences to the S corporation under I.R.C. §1374 are determined using the same analysis contained in Example 1 of Treas. Reg. §1.1374-4(a)(3). The wood products sold as inventory during the recognition period did not constitute separate assets held by the S corporation on the conversion date and thus their production and sale do not constitute a partial disposition of the timber property. See Rev. Rul. 72-515, 1972-2 C.B. 466 (treating growing timber as part of the underlying real property for purposes of I.R.C. §1031). **Accordingly, the S corporation's income on the sale of the resulting wood products during the recognition period is not recognized built-in gain within the meaning of §1374(d)(3) and is not taxed under I.R.C. §1374.**

Notwithstanding the treatment accorded income under I.R.C. §631, the income received from the sale of the resulting wood product, produced coal, or produced iron ore involves the receipt of normal operating business income in the nature of rent or royalties. See Rev. Rul. 77-109, 1977-1 C.B. 87 (holding that payments received from a disposal of coal to which I.R.C. §631(c) does not apply is ordinary income). The receipt of normal operating business income in the nature of rents and royalties is not subject to tax under I.R.C. §1374. There is no indication that Congress intended the capital gain tax rate benefits provided by I.R.C. §631 to cause normal operating business income from the cutting of timber or the extraction of minerals to be subject to tax under I.R.C. §1374. Moreover, I.R.C. §631(c) is designed to favor domestic production of iron ore and sales of coal and iron ore to unrelated parties. Applying I.R.C. §1374 to income taxed under I.R.C. §631(c) could have the anomalous effect of taxing sales of domestic iron ore more heavily than sales of foreign production and taxing sales of coal and iron to unrelated parties more heavily than sales to related parties. **Accordingly, an S corporation's gain recognized pursuant to I.R.C. §631(a), I.R.C. §631(b), or I.R.C. §631(c) during the recognition period is not recognized built-in gain within the meaning of I.R.C. §1374(d)(3).**

Holding

The S corporation's gain recognized in the transactions described in Situation 1, 2, 3, and 4 is not recognized built-in gain for purposes of I.R.C. §1374.

[Rev. Rul. 2001-50, 2001-43 IRB 343]

ESTATE AND GIFT TAX

Estate of Shackelford v. United States
[I.R.C. §§2031 and 7520]

> ☞ **Estate was not required to use annuity tables under I.R.C. §7520 to value lottery payments.**

Issue. This appeal presents the question of whether a statutory anti-assignment restriction on lottery payments justifies departure from the Department of Treasury's annuity tables when determining the asset's present value in calculating estate tax. Under the circumstances of this case, we conclude that it does and affirm the judgment of the district court.

Facts. At the time of Thomas J. Shackelford's untimely death, California law prohibited any assignment of lottery payments. On death, future payments were to be made to a deceased winner's estate according to the annuity terms. However, the payment of federal estate tax is not similarly structured. Thus, although the estate was limited to receiving annual installments, the estate tax was calculated based on the present value of the income stream, due on a much shorter schedule. Under the present value annuity tables in the Treasury Regulations, 26 C.F.R. section 20.2031-7, the present value of the remaining payments was calculated to be $4,023,903. This meant that the estate owed $1,543,397 in federal estate taxes without any concomitant source of revenue to fund the payment.

The estate argued that use of the annuity tables to value the payments resulted in an unrealistic and unreasonable value because it did not reflect the fair market value of the asset.

Analysis. The Internal Revenue Code imposes an estate tax on the "taxable estate of every decedent who is a citizen or resident of the United States" (I.R.C. §2001). The "taxable estate" is calculated by subtracting any allowable deductions from the value of the gross estate (I.R.C. §2051). The gross estate includes the total "[v]alue at the time of his death of all property, real or personal, tangible or intangible, wherever situated," to the extent the decedent had an interest in the property (I.R.C. §§2031 and 2033). This includes the value of annuities; thus, the value of the future lottery payments is included in Shackleford's gross estate (I.R.C. §2039).

The "value" of property to be included in the gross estate is the fair market value of the item at the time of the decedent's death. Treas. Reg. §20.2031-1(b). Non-commercial annuities, such as the lottery payments at issue, are valued pursuant to tables promulgated by the Secretary of the Treasury, except when another regulatory provision applies (I.R.C. §7520).

Although the tables provide the presumptive valuation of non-commercial annuities, courts have long recognized that a table-produced valuation is not applicable when the result is unrealistic and unreasonable. See, e.g., *Weller v. Comm'r* 38 T.C. 790, 803 (1962). In such cases, a modification to the valuation or a complete departure from the tables may be justified.

For these reasons, although the general rule requires that the tables be used because they provide both certainty and convenience when applied in large numbers of cases, see *Bank of California v. United States,* 672 F.2d 758, 759-60 [49 AFTR 2d 82-1512] (9th Cir. 1982), exceptions have been made when the tables do not reasonably approximate the fair market value of the asset. However, because the table-produced valuation is presumed correct, the party who desires to use an alternative method to value an estate's interest bears the "considerable burden of proving that the tables produce such an unrealistic and unreasonable result that they should not be used" (*O'Reilly,* 973 F.2d at 1408).

Holding. In this case, there is little doubt that the statutory restrictions on transfer reduced the fair market value of the right to receive future lottery payments. Thus, given the expert testimony presented, the district court did not err in analyzing fair market value by assuming a hypothetical market.

[*Estate of Shackelford v. United States*, 88 AFTR 2d 2001-5658 (9th Cir. 2001)]

GROSS INCOME

Sinyard v. Commissioner
[I.R.C. §§61 and 104]

> ☞ **Attorney's fees are included in plaintiff's gross income.**

Facts. In March 1989, James Sinyard joined two class action suits against IDS alleging age discrimination and other torts. Sinyard entered into an agreement with class action counsel, Winthrop & Weinstine, providing: "In the event of a recovery, Winthrop & Weinstine will be paid one-third (1/3) of the amount you obtain in the lawsuit, whether by settlement or jury award."

In 1992, the suits were settled. IDS agreed to pay $35 million "in full and complete settlement of all claims as described in this Agreement and the exhibits hereto"; the payment was to be made "to the 32 individual plaintiffs, Mervyn Taylor, and Winthrop & Weinstine, P.A., their attorneys." After deducting costs and disbursements of $1.7 million the 32 individual plaintiffs agreed to allocate one-third of the remaining total settlement amount as compensation for tort injuries to the plaintiffs, to allocate one-third of the settlement amount as compensation for lost wages, and to "allocate one-third of the settlement amount for payment of attorneys' fees pursuant to 29 U.S.C. §626(b) and 29 U.S.C. §216(b)." IDS agreed to pay the attorneys' fees plus amounts allocated to legal costs and disbursements "directly to Winthrop & Weinstine, P.A., or to an account designated by them." IDS agreed to withhold federal and state income taxes on the one-third of the settlement which was allocated as compensation for lost wages.

In accordance with the settlement, the proceeds were allocated as follows:

Total settlement payment	$35,000,000
Less costs and disbursements	$1,500,000
Net settlement proceeds	$33,500,000
Allocation of net settlement proceeds:	
Attorneys' fees (1/3)	$11,166,666.65
Tort damages	$12,616,666.70
Lost wages	$11,166,666.65

IDS issued a single check to Winthrop & Weinstine for $23,783,333.35, the sum of the tort damages and the attorneys' fees. The check was deposited in a trust account on behalf of the class action plaintiffs.

The Commissioner held the $252,608 in attorneys' fees is allowable as a miscellaneous itemized deduction. This deduction was reduced by 2% of Adjusted Gross Income, leaving a deduction of $240,984 for the attorneys' fees. The full amount of this deduction could not be taken because the Sinyards' income was subject to the Alternative Minimum Tax (the AMT). The result was the deficiency upheld by the Tax Court.

Issue. Whether the $252,608 in attorneys' fees should be treated as income to the Sinyards.

Analysis. If A owes B a debt, and C pays the debt on A's behalf, it is elementary that C's payment is income to A as well as to B. Here, James Sinyard had contracted to pay Winthrop & Weinstine one-third of what he might receive in settlement. **His obligation to the law firm was satisfied by IDS. The payment was therefore income to him.** "The discharge by a third person of an obligation to him is equivalent to receipt by the person taxed." *Old Colony Trust Co. v. Commissioner,* 279 U.S. 716, 729 [7 AFTR 8875] (1929).

The Sinyards maintain their case is different. It is one where A owes B but C is liable to B for the same debt and indeed is primarily liable. When C satisfies his obligation to B, C's payment arguably should not be treated as income to A. In the present case, IDS became liable to pay the attorneys' fees. It did so by virtue of the order of the court confirming the settlement and ordering IDS to perform according to its terms. IDS became primarily liable for the debt to Winthrop & Weinstine. When IDS discharged the debt it was bound to pay, the Sinyards say they received no income.

The Sinyards suggest that the ADEA is different from many fee-shifting statutes. The legislative history of the ADEA shows an intent to make the plaintiffs whole. The Fair Labor Standards Act remedy incorporated into the ADEA requires a judgment for the plaintiff to provide for attorneys' fees "in addition" to damages [29 U.S.C. §216(b)].

These observations do not alter the analysis of the tax law. The ADEA does make the injured plaintiff whole. The attorneys' fees are in addition to compensation for what he lost. The tax impact of the attorneys' fees arises from the Alternative Minimum Tax. Without its limitation, the attorneys' fees would be income to the Sinyards, and the income would be wiped out by deduction of the total received. It would be a wash. **The anomalous result, no doubt unintended, arises when part of the deduction is blocked by the AMT. We do not think we can change the basic rules of income tax in order to correct this result.** See *Benci-Woodward,* 219 F.3d at 944.

Holding. The attorneys' fees are included in the plaintiff's gross income.

Dissent of Judge McKeown

The majority concludes that a statutory attorneys' fee, awarded by the district court to the Sinyards' attorney under the fee-shifting provision of the Age Discrimination in Employment Act (ADEA), 29 U.S.C. I.R.C. §621 et seq., is taxable to the Sinyards as income. **This unfortunate result appears to be at odds with the express statutory language, which provides that the attorneys' fee award is "in addition" to the plaintiff's recovery, and with the intent of the statute, which is to make the plaintiff whole.** Because the majority's conclusion fails to account for the effect of the ADEA's fee-shifting provision, I respectfully dissent.

[*Sinyard v. Commissioner,* 88 AFTR 2d 2001-6034 (9th Cir. 2001)]

IRS PROCEDURES: ADDRESS AND MAILING ISSUES

Notice 2001-62
[I.R.C. §7502]

> ☞ **IRS provides updated list of designated PDSs for purposes of "timely mailed as timely filed" rule of I.R.C. §7502.**

This notice updates the list of designated private delivery services ("designated PDSs") set forth in Notice 99-41, 1999-2 C.B. 325, for purposes of the timely mailing treated as timely filing/paying rule of I.R.C. §7502, effective September 1, 2001. The IRS is adding two new delivery services to the list of designated PDSs.

Effective September 1, 2001, the list of designated PDSs is as follows:

1. Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, and Second Day Service;
2. DHL Worldwide Express (DHL): DHL "Same Day" Service and DHL USA Overnight;
3. Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, and FedEx 2 Day; and
4. United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

UPS Worldwide Express Plus and UPS Worldwide Express are added to the list published in Notice 99-41. Both of these services provide delivery services to the United States from foreign countries. Airborne, DHL, FedEx, and UPS are not designated with respect to any type of delivery service not identified above.

[Notice 2001-62, 2001-40 IRB 307]

ITEMIZED DEDUCTIONS

Mellon Bank, N.A. v United States
[I.R.C. §67]

> ☞ **Fees paid by trust for investment advice are subject to the 2% of AGI floor.**

Facts. In the taxable years 1989 through 1992, inclusive, some or all of the Plaintiff Trusts incurred costs for the services of Richard K. Mellon and Sons and of certain investment specialists. The Plaintiff Trusts stipulate that they will not argue that any of these costs "would not have been incurred if the property were not held in such trust or estate."

Issue. The question is whether a trustee's costs are subject to the 2 percent floor established by I.R.C. §67(a) unless the costs occur only in the context of trust administration and are not routinely incurred by individual investors.

Analysis. I.R.C. §67 provides:

> **a.** General rule.–In the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income. ***
>
> **e.** Determination of adjusted gross income in case of estates and trusts.–For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that–
>
> > **1.** the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate, and ***
>
> shall be treated as allowable in arriving at adjusted gross income.

It is undisputed that trustee fees are fully deductible. Mellon maintains that trustee fees are merely a label for fiduciary services performed by the trustee. It thus argues that there are really no unique "trustee" services–all are requirements of state fiduciary law. Services delegated by the trustee remain subject to fiduciary standards and are fiduciary services under governing law. Therefore, payments for outside fiduciary services are in fact, trustee fees, and should be fully deductible under I.R.C. §67(e)(1).

The Tax Court denied the deduction, reasoning that such fees were not "*Unique* to the administration" of a trust and "[i]ndividual investors routinely incur costs for investment advice as an integral part of their investment activities." [*O'Neill v. Comm'r,* 98 T.C. 227, 230 (1992)]. However, the Sixth Circuit reversed, finding that individual investors are "not *required* to consult advisors and suffer no penalties or potential liability if they act negligently for themselves" [994

F.2d at 304]. The court concluded that "fiduciaries uniquely occupy a position of trust for others and have an obligation to the beneficiaries to exercise proper skill and care with the assets of the trust" [Id]. Therefore, the fees were eligible for the I.R.C. §67(e) exception and not subject to the 2 percent floor requirement of I.R.C. §67(a) [Id].

We agree with the Sixth Circuit's conclusion that different legal obligations apply to assets held in a trust. **In construing the federal income tax code, however, we are not bound by the fiduciary standards established by state law, and must instead defer to Congress and the plain meaning of the statute.**

First, fees are fully deductible if they are "costs which are paid or incurred in connection with the administration of the estate or trust." This prerequisite defines the relationship between the costs and the administration of the trust. All expenses resulting from the fiduciary obligations of the trustee satisfy the first prerequisite. Mellon Bank's proposed construction of the statute would end here. Mellon Bank argues that trustees are fulfilling their fiduciary duty when they, acting in good faith, incur expenses in connection with the administration of a trust. **Therefore, as Mellon asserts, all expenses incurred by a trustee in connection with the administration of a trust would be fully deductible. This argument eliminates the second requirement of I.R.C. §67(e)(1), which is directed to the question of whether an expense would not have been incurred if there had been no trust.**

Our interpretation, however, must give full effect to the entire statute, not merely the first clause. The second clause of I.R.C. §67(e)(1) serves as a filter, allowing a full deduction only if such fees are costs that "would not have been incurred if the property were not held in such trust or estate." The requirement focuses not on the relationship between the trust and costs, but the type of costs, and whether those costs would have been incurred even if the assets were not held in a trust. **Therefore, the second requirement treats as fully deductible only those trust-related administrative expenses that are unique to the administration of a trust and not customarily incurred outside of trusts.**

Investment advice and management fees are commonly incurred outside of trusts. An individual taxpayer, not bound by a fiduciary duty, is likely to incur these expenses when managing a large sum of money.

Holding. Therefore, these costs are *not* exempt under I.R.C. §67(e)(1) and are required to meet the 2 percent floor of I.R.C. §67(a).

[*Mellon Bank, N.A. v. United States,* 88 AFTR 2d 2001-5800 (Fed. Cir. 2001)]

PRINCIPAL RESIDENCE

Rev. Rul. 2001-57
[I.R.C. §§1, and 121]

☞ **Gain from the mark to market election under §311(e) of the Taxpayer Relief Act of 1997 cannot be excluded from income under I.R.C. §121.**

Issue. If an individual elects under §311(e) of the Taxpayer Relief Act of 1997 (TRA 97) to treat the individual's principal residence as being both sold and reacquired on January 1, 2001, for an amount equal to its fair market value on that date (§311(e) election), can the individual exclude from gross income under I.R.C. §121 any of the gain resulting from the deemed sale?

Facts. A makes a §311(e) election with respect to A's principal residence on A's federal income tax return for the year including January 1, 2001. On January 1, 2001, the residence had a fair market value that was $250,000 greater than A's basis. If, on that date, A had actually sold the residence for its fair market value, I.R.C. §121 would have entitled A to exclude from gross income the full $250,000 of gain realized on the sale.

Law and Analysis. Under I.R.C. §121, a taxpayer may exclude from gross income up to $250,000 ($500,000 in the case of certain jointly filed returns) of gain realized on the sale or exchange of property, if that property was owned and used as the taxpayer's principal residence for an aggregate period of 2 years or more during the 5-year period ending on the date of the sale or exchange. The full exclusion is available only once every 2 years.

Under I.R.C. §1(h)(1), gain resulting from the sale or exchange of most capital assets is taxed at a capital gains rate of 20 percent (10 percent for gain otherwise taxed at an ordinary rate of 15 percent or less).

I.R.C. §1(h)(2) provides reduced capital gains rates for qualified 5-year gain, generally defined in I.R.C. §1(h)(9) as "the aggregate long-term capital gain from property held for more than 5 years." I.R.C. §1(h)(2)(B) provides that the 20-percent capital gains rate is reduced to 18 percent for qualified 5-year gain resulting from the sale or exchange of property with a holding period beginning after December 31, 2000.

Section 311(e) of TRA 97 allows a non-corporate taxpayer holding a capital asset on January 1, 2001, to elect to treat that asset as having been both sold and reacquired on that date for an amount equal to its fair market value. Thus, if the election is made, the holding period for the asset begins after December 31, 2000, making the asset eligible for the 18-percent rate if it is later sold when the taxpayer has a holding period of more than 5 years in the asset. Section 311(e)(2)(A) of TRA 97 provides, "Any gain resulting from [a §311(e) election] shall be treated as received or accrued on the date the asset is treated as sold . . . and shall be recognized notwithstanding any provision of the . . . Code."

Pursuant to A's §311(e) election, A is deemed to have both sold and reacquired A's principal residence for an amount equal to its fair market value on January 1, 2001. As stated above, I.R.C. §121 would entitle A to exclude from gross income gain from an actual sale. **Thus, the question presented is how to reconcile the requirement that the gain from the deemed sale be "recognized notwithstanding any other provision" of the Internal Revenue Code and the mandate in I.R.C. §121 that "[g]ross income shall not include gain" from a qualifying sale or exchange of a principal residence.**

In interpreting an internal revenue statute, it is necessary to infer legislative intent from all of the facts and circumstances. These factors include the role that the provision at issue plays in the structure of the internal revenue law, the statutory language, and all relevant legislative history. See *United States v. American Trucking Ass'ns*, 310 U.S. 534, 542-45 (1940); *United States v. Dickerson*, 310 U.S. 554, 561-62 (1940).

A §311(e) election confers tax benefits on the electing taxpayer (a holding period that begins after December 31, 2000, and a step-up in basis), but it imposes a tax cost as well (current recognition of gain resulting from any existing appreciation in the asset). **Exclusion of the gain from the deemed sale would frustrate this balancing of benefits and burdens.** For this reason, the statutory requirement that gain be recognized "notwithstanding any other provision" of the Internal Revenue Code necessarily precludes application of the exclusion from gross income under I.R.C. §121, or else the intended consequences of the mandated recognition (taxation of the gain) would be prevented. The legislative history of the §311(e) election is consistent with this conclusion. "If the election is made, any gain is recognized (and any loss disallowed)." H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 383 (1997).

Holding. If an individual elects under §311(e) of TRA 97 to treat the individual's principal residence as being both sold and reacquired on January 1, 2001, for an amount equal to its fair market value on that date, **the individual cannot exclude from gross income under I.R.C. §121 any of the gain resulting from the deemed sale.**

[Rev. Rul. 2001-57, 2001-46 IRB 488]

FSA 200137033
[I.R.C. §163(h)]

> ☞ **If taxpayers' principal residence is provided by H's employer, taxpayers can deduct interest paid on the mortgage for only one of the two residences they own.**

Facts. Taxpayers are married and file a joint tax return. They owned two residences and lived in a third residence that was provided by H's employer.

Issue. Whether taxpayers are entitled to claim mortgage interest deductions for the two residences they own for a time period during which they lived in a third residence provided to them by H's employer.

Analysis. Taxpayers other than corporations may deduct qualified residence interest. Under I.R.C. §163(h)(3), the term "qualified residence interest" means any interest which is paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness with respect to any qualified residence of the taxpayer.

I.R.C. §163(h)(4)(A) defines "qualified residence" as a taxpayer's principal residence, within the meaning of I.R.C. §121, and one other residence that the taxpayer selects for this purpose and uses as a residence, within the meaning of I.R.C. §280A(d)(1). In the case of married individuals filing separate returns, I.R.C. §163(h)(4)(A)(ii) provides that the couple shall be treated as one taxpayer for purposes of determining "principal residence" and "one other residence" within the meaning of "qualified residence." Furthermore, each individual may take into account only one residence unless both individuals consent in writing to one individual taking into account the principal residence and one other residence.

Although for purposes of I.R.C. §163(h)(4)(A) two married individuals typically have one common principal residence, **it is possible that under appropriate facts and circumstances, each spouse may have his or her own, separate principal residence** (e.g., the facts and circumstances establish that H's principal residence is in one location but W's principal residence is in another). If two married individuals who are found to have separate principal residences also own a third residence, an issue may arise concerning which two of the three residences constitute the couple's "qualified residence" (principal residence plus one other residence) for purposes of the mortgage interest deduction. I.R.C. §163 and the temporary regulations are silent as to how such a couple would determine their principal residence and one other residence. **In the absence of regulations, we believe it appropriate for such a couple to select one of the principal residences as their "principal" residence, and either the other**

principal residence or the third residence as their "other" residence.

Although I.R.C. §163(h)(4)(A) does not specifically state that a married couple filing jointly is treated as one taxpayer for purposes of determining their mortgage interest deductions, we assume that Congress did not intend to treat married couples filing jointly differently than married couples filing separately. Thus, a married couple filing jointly would also be treated as one taxpayer and would be entitled to take into account only a principal residence and one other residence for purposes of calculating their mortgage interest deduction.

Which residence constitutes taxpayers' principal residence in the instant case depends on all the facts and circumstances. Under the proposed regulations and Rev. Rul. 77-298, the determination would be based on where they resided the majority of the time during year 1. Additional factors to consider include the taxpayers' intent, location of their employment, where they file state tax returns, and what state or municipality issued their driver's licenses.

Conclusion. Once a determination of taxpayers' principal residence has been made, then taxpayers may select another residence, within the perimeters discussed above, to be treated as their "other" residence. **If the third residence (the one provided in connection with H's job) is their principal residence, then taxpayers have two options concerning their other residence.** First, they may select the State A residence as their other residence for year 1. Second, they may select the State A residence as their other residence from date 1 through date 3, and then select the State B residence as their other residence from date 4, the date of acquisition, through the end of year 1. **Finally, if either the State A or State B residence is their principal residence, then taxpayers may select the remaining residence as their other residence during year 1.**

[FSA 200137033]

RETIREMENT PLANS

Notice 2001-56
[I.R.C. §§401 and 416]

> ☞ **Guidance is provided on the effective dates of changes in the retirement plan qualification rules under the 2001 Act.**

This notice provides guidance relating to the effective dates for §611(c), §613, and §636(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107-16. Section 611(c) of EGTRRA increases the compensation limit of I.R.C. §401(a)(17) and related sections. Section 613 of EGTRRA modifies the rules in I.R.C. §416 regarding determination of top-heavy status. Section 636(a) of EGTRRA directs the Secretary to revise the regulations relating to hardship distributions under I.R.C. §401(k)(2)(B)(i)(IV).

Notice 2001-42, 2001-30 IRB 70, provides a remedial amendment period for EGTRRA, in which any needed retroactive remedial EGTRRA plan amendments may be adopted. The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of required good faith EGTRRA plan amendments. See Notice 2001-57 for sample good faith amendments. Although a good faith plan amendment need not reflect all guidance issued under EGTRRA, the plan's operation must be consistent with that guidance, beginning with the effective date of that guidance.

[Notice 2001-56, 2001-38 IRB 277]

Notice 2001-57
[I.R.C. §401]

> ☞ **Sample plan amendments that reflect changes made to plan qualification requirements by the 2001 Act are provided.**

Purpose. This notice provides sample plan amendments for the changes to the plan qualification requirements under I.R.C. §401(a) that were made by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16 (EGTRRA). These sample amendments will help plan sponsors and sponsors and adopters of pre-approved plans comply with the requirement to adopt good faith EGTRRA plan amendments on a timely basis.

In some cases, plan sponsors may be able to adopt the sample amendments verbatim. In other cases, plan sponsors may have to modify the sample amendments to make the amendments appropriate for adoption in their plans.

The sample amendments are examples of plan amendments that satisfy the good faith requirement and should not be viewed as interpretive guidance on the EGTRRA changes to the qualification requirements. Other guidance will address the EGTRRA changes. See, for example, Notice 2001-56.

[Notice 2001-57, 2001-38 IRB 279]

Announcement 2001-93
[I.R.C. §414]

> ☞ **IRS advises employers how to report I.R.C. §414(v) elective deferral catch-up contributions beginning in 2002 on Form W-2 and Form 5498.**

The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) added I.R.C. §414(v). For 2002, I.R.C. §414(v) enables applicable employer plans to allow eligible participants who are age 50 or over to make additional elective deferrals, i.e., "catch-up" contributions.

For 2002, employers are required to report participants' elective pension deferrals on Form W-2 in box 12 using Codes D through H and S. For employees' qualified catch-up contributions after 2001, employers must report the elective deferral catch-up contributions in the totals reported for Codes D through H and S.

The reporting of catch-up contributions will be addressed in the 2002 Instructions for Forms 1099-R and 5498. No major changes are anticipated.

[Announcement 2001-93, 2001-44 IRB 416]

Revenue Ruling 2001-51
[I.R.C. §415]

> ☞ **Guidance is provided for plans implementing the increase in the I.R.C. §415 limits and plan benefits under the 2001 Act.**

This revenue ruling provides guidance relating to the increases in the limitations of I.R.C. §415 enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107-16. Specifically, this revenue ruling provides questions and answers on:

- Benefit increases that may be provided as a result of the increased I.R.C. §415 limitations under EGTRRA;
- Plan amendments that may be adopted to take into account the increased I.R.C. §415 limitations under EGTRRA;
- The effect of the increased I.R.C. §415 limitations under EGTRRA on other qualification requirements; and
- How the "sunset" provision of EGTRRA is taken into account for purposes of I.R.C. §§412 and 404.

[Revenue Ruling 2001-51, 2001-45 IRB 427]

Proposed Regulation §1.414(v)-1
[I.R.C. §414]

> ☞ **Proposed regulations implement the catch-up provisions for contributions to retirement plans under the 2001 Act.**

Explanation of Provisions

These proposed regulations would implement new I.R.C. §414(v) by providing that an employer plan is not treated as violating any provision of the Internal Revenue Code solely because the plan permits a catch-up eligible participant (as defined in these proposed regulations) to make catch-up contributions. Catch-up contributions generally are elective deferrals made by a catch-up eligible participant that exceed an otherwise applicable limit and that are treated as catch-up contributions under the plan, but only to the extent they do not exceed the maximum amount of catch-up contributions permitted for the taxable year. **An employer is not required to provide for catch-up contributions in any of its plans, even if the plans provide for elective deferrals.** If, however, any plan of an employer provides for catch-up contributions, all plans of the employer that provide elective deferrals must comply with the universal availability requirements described below.

A. Eligibility for Catch-Up Contributions

Under these proposed regulations, a participant is a catch-up eligible participant, and thus is permitted to make catch-up contributions, if the participant is otherwise eligible to make elective deferrals under the plan and is age 50 or older. For purposes of this rule, a participant who is projected to attain age 50 before the end of a calendar year is deemed to be age 50 as of January 1 of that year. The effect of this rule is that all participants who will attain age 50 during a calendar year are treated the same beginning January 1 of that year, without regard to whether the participant survives to his or her 50th birthday or terminates employment during the year and without regard to the employer's choice of plan year.

A catch-up eligible participant can make catch-up contributions under an I.R.C. §401(k) plan, a SIMPLE IRA plan as defined in I.R.C. §408(p), a simplified employee pension as defined in I.R.C. §408(k) (SEP), a plan or contract that satisfies the requirements of I.R.C. §403(b), or an I.R.C. §457 eligible governmental plan, as long as the participant can otherwise make elective deferrals under the plan or contract. For this purpose, elective deferrals include not only elective deferrals defined in I.R.C. §402(g)(3), but also any contribution to a I.R.C. §457 eligible governmental plan.

B. Determination of Catch-Up Contribution

Under the proposed regulations, catch-up contributions would be determined by reference to three types of limits: statutory limits, employer-provided limits, and the actual deferral percentage (ADP) limit.

Under the proposed regulations, elective deferrals in excess of an applicable limit would be treated as catch-up contributions only to the extent that such elective deferrals do not exceed the catch-up contribution limit for the taxable year reduced by elective deferrals previously treated as catch-up contributions for the taxable year. The catch-up contribution limit for a taxable year is generally the applicable dollar catch-up limit for such taxable year, except that an elective deferral will not be treated as a catch-up contribution to the extent that the elective deferral, when added to all other elective deferrals for the taxable year under all plans of the employer, exceeds the participant's compensation (determined in accordance with I.R.C. §415(c)(3)).

C. Treatment of Catch-Up Contributions

If an elective deferral is treated as a catch-up contribution, it is not subject to otherwise applicable limits under the plan and the plan will not be treated as failing otherwise applicable nondiscrimination requirements because of the making of catch-up contributions. The proposed regulations would provide guidance on how catch-up contributions under the plan are taken into account for purposes of these various requirements under the Internal Revenue Code. Under the proposed regulations, catch-up contributions would not be taken into account in applying the limits of I.R.C. §§401(a)(30), 401(k)(11), 402(h), 402A(c)(2), 403(b), 404(h), 408(k), 408(p), 415, or 457 to other contributions or benefits under the plan offering catch-up contributions or under any other plan of the employer.

D. Universal Availability

Under the proposed regulations, a plan that offers catch-up contributions would satisfy the requirements of I.R.C. §401(a)(4) only if all catch-up eligible participants are provided with the effective opportunity to make the same dollar amount of catch-up contributions. Therefore, if an employer provides for catch-up contributions under an I.R.C. § 401(k) plan, all other employer plans in the controlled group that provide for elective deferrals, including plans not subject to I.R.C. §401(a)(4), must provide catch-up eligible participants with the same effective opportunity to make catch-up contributions. This universal availability requirement applies solely with respect to catch-up eligible participants. **Because the definition of catch-up eligible participants requires that the participant be eligible to make elective deferrals under a plan without regard to I.R.C. §414(v), the universal availability requirement will not require plans that do not otherwise provide for elective deferrals to provide for catch-up contributions.**

E. Participants in Multiple Plans

The intent of I.R.C. §414(v) is to permit a catch-up eligible participant to make elective deferrals in an amount equal to the catch-up contribution limit for the year in addition to the amount of elective deferrals that the participant would otherwise have been allowed to defer under the plan or plans in which the catch-up eligible participant participated. Many of the statutory limits that would otherwise limit the participant's elective deferrals are applied on an aggregated basis, for example, across all plans within a controlled group. Accordingly, the proposed regulations would provide that, for purposes of determining whether elective deferrals are in excess of a statutory limit, **all elective deferrals in excess of the statutory limit are aggregated in the same manner as the underlying limit and the aggregate amount of elective deferrals treated as catch- up contributions because they exceed the statutory limit must not exceed the applicable dollar catch-up limit.**

F. Excludability of Catch-Up Contributions

Catch-up contributions are generally not treated as exceeding the applicable dollar amount of I.R.C. §402(g)(1). The proposed regulations would also provide that a catch-up eligible participant who participates in multiple plans may treat an elective deferral as a catch-up contribution (up to the maximum amount of catch-up contributions permitted for the taxable year) because it exceeds the catch-up eligible participant's I.R.C. §402(g) limit for the taxable year. This rule would allow a catch-up eligible participant who participates in plans of two or more employers an exclusion from gross income for elective deferrals that exceed the I.R.C. §402(g) limit, even though the elective deferrals do not exceed an applicable limit for either employer's plan. The treatment by an individual of such elective deferrals as catch-up contributions will not have any impact on either employer's plan. This treatment is parallel to the treatment of excess deferrals for an individual under age 50 who exceeds the I.R.C. §402(g) limit in the plans of two unrelated employers. Accordingly, the proposed regulations would not provide for the ADP test to be rerun to disregard elective deferrals that an individual treats as catch-up contributions because they exceed the I.R.C. §402(g) limit. **However, the total amount of elective deferrals in excess of the applicable dollar limit in I.R.C. §402(g)(1)(B) that are not includible in income because they are treated as catch-up contributions cannot exceed that limit by more**

than the catch-up contribution limit for the taxable year.

Proposed Effective Date

The regulations are proposed to apply to contributions in **taxable years beginning on or after January 1, 2002. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations.** If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

[Prop. Reg. §1.414(v)-1, Fed. Reg. Vol. 66, no. 205, p. 53555]

TERRORIST ATTACKS

IR 2001-82 (September 19, 2001)

[I.R.C. § 501]

> ☞ **The IRS announced speedier processing of requests for tax-exempt status.**

The IRS announced it will speed processing of requests for tax-exempt status from new charities formed to assist victims of the September 11 terrorist attacks.

The IRS also has established a special expedited review and approval process for new organizations seeking tax-exempt status to provide relief to the victims. New organizations should apply for tax-exempt status by filing IRS Form 1023, available at www.irs.gov and write at the top of the form "Disaster Relief, Sept. 11, 2001." The IRS will give such applications immediate attention.

Form 1023 and its instructions contain the addresses for submitting the application–one for regular mail and another for express mail or a delivery service. In addition, those seeking more information about applying for charitable tax-exempt status can call the IRS toll-free phone number for exempt organizations determinations, 1-877-829-5500.

[IR 2001-82 (September 19, 2001)]

Notice 2001-61

[I.R.C. §§6081, 6161, and 7508A]

> ☞ **Guidance is provided for taxpayers affected by the September 11, 2001 terrorist attacks who are seeking relief from filing and estimated payment deadlines.**

In the aftermath of terrorist attacks that took place in New York and Washington, D.C., on September 11, 2001, and subsequent presidential disaster declarations, the IRS has provided relief to affected taxpayers. Generally, those seeking relief from certain filing and estimated payment deadlines should mark "September 11, 2001 Terrorist Attack" in red ink on all documents submitted to IRS.

Individuals located within "affected areas" (as defined by regulations under I.R.C. §7508A) **have until February 12, 2002, to file their 2000 gift tax or income tax returns,** and, while IRS can't postpone payment of tax, it will disregard the period of 120 days from September 11, 2001, to January 9, 2002, in determining any failure to pay penalties.

Taxpayers other than individuals are granted both a 120-day postponement under I.R.C. §7508A and a 6-month extension to file under I.R.C. §6081 and I.R.C. §6161 to file returns originally due on or after September 11, 2001, and on or before November 30, 2001. The postponement and extension are intended to run consecutively.

Estimated tax payments that were due from individuals, corporations, estates, and trusts on or after September 11, 2001, and before January 15, 2002, are postponed under I.R.C. §7508A until January 15, 2002, including third estimated tax payment, which was originally due on October 1, 2001, for corporations, and on September 17, 2001, for individuals. Affected taxpayers have a 120-day postponement to perform other acts enumerated under Treas. Reg. §301.7508A-1(c)(1) and those who have difficulty meeting tax obligations but don't otherwise qualify for relief described above have until November 15, 2001, to file and make payments that are due between September 11, 2001, and October 31, 2001. Although IRS can't extend or postpone time for making tax deposits under I.R.C. §6302, it will waive I.R.C. §6656 additions to tax if deposits that were required to be made between September 11, 2001, through October 31, 2001, if deposit is made on or before November 15, 2001, because reasonable cause for failure to deposit exists for those taxpayers, and their service providers were injured or their records and supporting services were damaged by attacks.

[Notice 2001-61, 2001-41 IRB 305]

Notice 2001-63
[I.R.C. §§6081, 6161, and 7508A]

> ☞ **IRS has postponed due date for all tax obligations other than federal tax deposits that were due between September 10 and September 24, to September 24, 2001.**

The Treasury Department and the IRS recognize that the continuing disruption to the nation's financial markets, transportation system, and telecommunication and computer networks, and continuing security concerns have made it difficult for many taxpayers to meet their September 17, 2001, filing and payment requirements, and for their representatives to assist them in doing so. This notice provides additional tax relief under I.R.C. §§6081, 6161, and 7508A for taxpayers who, regardless of their location, are continuing to experience difficulties in meeting their filing and tax payment requirements on account of events related to the September 11, 2001, terrorist attack.

The IRS has determined that the due date for all federal tax obligations falling between September 10, 2001, and September 24, 2001, is postponed to September 24, 2001. This postponement of time covers the filing of returns and claims for refund, the payment of tax (including estimated tax payments), making elections, and filing any other federal tax documents. The postponement does not apply to deposits of federal taxes. For relief with respect to deposits of federal taxes, see Notice 2001-61.

[Notice 2001-63, 2001-40 IRB 308]

Announcement 2001-103
[I.R.C. §§412, 6058, and 6059]

> ☞ **Relief from penalties for failure to make required pension plan contributions on or before September 15, 2001, is announced.**

Due to terrorist attacks and inability of many employers to make required pension plan contributions on or before September 15, 2001, to meet minimum funding standards, IRS, PWBA, and PBGC won't regard defined benefit or money purchase pension plan to have filed incomplete or inaccurate Form 5500 under I.R.C. §6058 or ERISA §104 solely because contributions made on or before September 24, 2001, are included on line 3 of Schedule B of Form 5500 and line 6(b) of Schedule R of Form 5500. Relief from penalty also applies to actuarial report under I.R.C. §6059(b). To be eligible for relief, plan must have plan year that ended on or after December 27, 2000, and on or before January 8, 2001, for which Form 5500 is required to be filed on or before October 15, 2001.

Background

I.R.C. §412(a) and §302(a) of the Employee Retirement Income Security Act of 1974 (ERISA) provide that a plan meets the minimum funding standards of the Internal Revenue Code and ERISA for a plan year if the plan does not have an accumulated funding deficiency as of the end of the plan year. I.R.C. §412(c)(10) and §302(c)(10) of ERISA provide that, for purposes of satisfying the minimum funding requirements of the Internal Revenue Code and ERISA, any contributions for a plan year made by an employer by the end of the 8½-month period following the end of such plan year are deemed to have been made on the last day of the plan year.

I.R.C. §6058 and §104 of ERISA require plan administrators to file an annual return/report of employee benefit plan within a specified period of time after the end of the plan year. The annual return/report of employee benefit plan is Form 5500 and Form 5500-EZ (hereinafter Form 5500). For defined benefit pension plans subject to the minimum funding standard, I.R.C. §6059 requires that a periodic report of the actuary be filed with the annual return. Under §301.6059-1 of the Procedure and Administration Regulations, the periodic report is the Schedule B, which must be signed by an enrolled actuary. In order to properly complete the Schedule B, the enrolled actuary must know whether a contribution for a plan year was made within the period specified by I.R.C. §412(c)(10) and §302(c)(10) of ERISA.

Under §502(c)(2) of ERISA, a penalty of up to $1,100 a day may be assessed for each day a plan administrator fails or refuses to file a complete and accurate annual report and accompanying schedules. Similarly, I.R.C. §6652(e) imposes a penalty of $25 a day (up to $15,000) for not filing returns for certain deferred compensation plans. I.R.C. §6692 imposes a penalty of $1,000 for not filing an actuarial report described in I.R.C. §6059. Under Treas. Reg. §301.6692-1(a), a failure to provide a material item of information is considered as a failure to file an actuarial report.

Because of the disruption of the financial markets caused by the events of September 11, 2001, many employers have stated they were not able to make required contributions to their pension plans on or before September 15, 2001, to satisfy the minimum funding standards.

Grant of Relief

The IRS, the PWBA, and the PBGC provide the following relief. In the case of a defined benefit or money purchase pension plan with a plan year ending on or after December 27, 2000, and on or before January 8, 2001, for which a Form 5500 is required to be filed on or before October 15, 2001, plan administrators and plan sponsors will not be treated as failing to file a complete and accurate return/report under I.R.C. §6058 or §104 of ERISA, nor will enrolled actuaries be treated as failing to file an actuarial report that satisfies the requirements of I.R.C. §6059(b), solely because contributions made on or before September 24, 2001, are included on line 3 of Schedule B of Form 5500 (showing the actual date of payment of the contribution) and line 6(b) of Schedule R of Form 5500.

In addition, the PBGC provides the following relief with respect to any plan with a plan year ending on or after December 27, 2000, and on or before January 8, 2001. The PBGC will not assess any penalties for a failure to pay PBGC premiums in a timely manner or a failure to meet a PBGC reporting or disclosure requirement, nor will it treat a certification as failing to be a valid and correct certification, solely because contributions made on or before September 24, 2001, are included in the plan's assets for purposes of PBGC premiums or are counted for purposes of determining whether any PBGC reporting or disclosure requirement applies.

[Announcement 2001-103, 2001-43 IRB 375]

Notice 2001-70
[I.R.C. §168]

☞ **Taxpayers can elect out of the mid-quarter depreciation convention rules under I.R.C. §168(d)(3) for property placed in service in the tax year if the third quarter includes September 11, 2001.**

This notice announces that the Treasury Department and the Internal Revenue Service intend to issue regulations permitting taxpayers to elect not to apply the mid-quarter convention rules contained in I.R.C. §168(d)(3) to certain property placed in service in the taxable year that includes September 11, 2001. This notice also provides taxpayers a mechanism for making the election before regulations are issued.

I.R.C. §168(d)(3) generally provides that, except as provided in regulations, if the aggregate basis of property placed in service during the last three months of the taxable year exceeds 40 percent of the aggregate basis of property (other than property described in I.R.C. §168(d)(3)(B)) placed in service during the taxable year, the applicable depreciation convention for all property (other than property described in I.R.C. §168(d)(2)) to which I.R.C. §168 applies placed in service during the taxable year is the mid-quarter convention.

Many taxpayers time the acquisition and placing in service of property within a taxable year to avoid application of the mid- quarter convention. Treasury and the IRS have been made aware that, as a result of events related to the September 11, 2001, terrorist attacks, many taxpayers have encountered difficulty completing the acquisition and placing in service of property in accordance with plans developed earlier in the year, and certain taxpayers would choose to delay acquisition and placing of property in service during the last quarter of their taxable year if failing to delay would result in application of the mid-quarter convention.

Accordingly, if the third quarter of the taxpayer's 2001 taxable year includes September 11, 2001, then the taxpayer may elect to apply the half-year convention to all property (other than property described in I.R.C. §168(d)(2)) placed in service during the taxpayer's 2001 taxable year for purposes of I.R.C. §168(d).

To make the election under this notice, a taxpayer must write "Election Pursuant to Notice 2001-70" across the top of its Form 4562, Depreciation and Amortization, for the taxpayer's taxable year that includes September 11, 2001.

Treasury and the IRS intend to amend the regulations under I.R.C. §168 to incorporate the guidance set forth in this notice. Until the regulations are amended, taxpayers may rely on the guidance set forth in this notice.

[Notice 2001-70, 2001-45 IRB 437]

Notice 2001-74
[I.R.C. §168]

☞ **Taxpayers can elect out of the mid-quarter depreciation convention rules under I.R.C. §168(d)(3) for property placed in service in the tax year if the fourth quarter includes September 11, 2001.**

This notice supplements the tax relief granted in Notice 2001-70, 2001-45 IRB 437, published November 5, 2001, by expanding the class of taxpayers entitled to the relief and clarifying the instructions for making the election provided under Notice 2001-70.

Treasury and the IRS have been made aware that certain taxpayers that are not entitled to relief under Notice 2001-70 because the third quarter of their 2001 taxable year does not include September 11, 2001, are purchasing property to replace property destroyed in the September 11, 2001, terrorist attack. As a result of these purchases, some of these taxpayers would be required to apply the mid-quarter convention. Such a result may place these taxpayers at a competitive disadvantage because other similarly situated taxpayers have received relief under Notice 2001-70.

Accordingly, Notice 2001-70 is expanded to provide that if the fourth quarter of a taxpayer's taxable year includes September 11, 2001, then the taxpayer may elect, for purposes of I.R.C. §168(d), to apply the half-year convention to all property (other than property described in I.R.C. §168(d)(2)) placed in service during the taxpayer's taxable year that includes September 11, 2001. The election is made in the same manner provided in Notice 2001-70.

In addition, certain taxpayers are required to file Form 2106, Employee Business Expenses, rather than Form 4562, Depreciation and Amortization, to report certain depreciation expenses. Accordingly, these taxpayers may make the election provided under Notice 2001-70, as supplemented by this notice, by writing "Election Pursuant to Notice 2001-70" across the top of the taxpayer's Form 2106. Taxpayers filing their returns electronically may make the election provided under Notice 2001-70, as supplemented by this notice, by typing "Election Pursuant to Notice 2001-70" in the Election Explanation (ELC) record when filing the Form 4562 or Form 2106.

Treasury and the IRS intend to amend the regulations under I.R.C. §168 to incorporate the guidance set forth in this notice. Until the regulations are amended, taxpayers may rely on the guidance set forth in this notice.

[Notice 2001-74, 2001-49 IRB 551]

Announcement 2001-112

[I.R.C. §6315]

> ☞ **Taxpayers may redesignate estimated tax payments as employment tax deposits or withheld income tax payments.**

Many taxpayers have informed the IRS that their income for the current year will be substantially less than previously expected because of economic disruptions resulting from the September 11, 2001, Terrorist Attack. Some taxpayers who made estimated income tax payments now believe their tax liability for their current taxable year will be lower than the sum of the estimated tax payments they have already made. Several of these taxpayers have asked whether the IRS will permit them to redesignate their estimated income tax payments, in whole or in part, as deposits to satisfy their obligations to deposit employment and withheld income taxes.

This announcement clarifies that the IRS will permit the redesignation of estimated income tax payments as tax deposits to satisfy obligations to deposit employment taxes imposed by chapters 21, 22, and 23 of the Internal Revenue Code, and income taxes withheld under chapter 24. To make this redesignation, a taxpayer should contact the IRS through its Disaster Relief toll-free telephone number: 1-866-562-5227.

Taxpayers who wish to redesignate their estimated tax payments should keep in mind their estimated income tax obligations. If, as a result of the redesignation, the amount of estimated tax payments is reduced below the amount required to satisfy the taxpayer's estimated income tax obligation, the taxpayer may be liable for additions to tax under I.R.C. §§6654 or 6655.

[Announcement 2001-112, 2001-46 IRB 494]

Notice 2001-68

[I.R.C. §§6081, 6161, and 7508A]

> ☞ **Relief available to taxpayers affected by September 11th Terrorist Attacks is expanded.**

This notice supplements the tax relief granted in Notice 2001-61, 2001-40 IRB 305 (October 1, 2001), for taxpayers affected by the September 11, 2001, Terrorist Attack (the "Terrorist Attack") by clarifying and expanding the definition of affected taxpayer, listing additional acts for which a postponement is granted, and providing other relief. The relief provided to taxpayers in this notice will apply retroactively to September 11, 2001.

This notice also postpones the deadlines for certain acts performed by the IRS. The postponement of these deadlines is **not** retroactive to September 11, 2001. Thus, the IRS deadlines are postponed only if the last day for performing the act (e.g., making a tax assessment) would otherwise be on or after November 2, 2001.

Taxpayers who believe they are entitled to relief under this notice should mark "September 11, 2001, Terrorist Attack" in red ink on the top of their returns and other documents submitted to the IRS and petitions submitted to the United States Tax Court. **Taxpayers should not put this notice on envelopes**. Doing so may result in a delay in the delivery or processing of the return or document.

Taxpayers that do not qualify for relief under Notice 2001-61 or this notice may still qualify for extensions and relief from penalties for reasonable cause. Reasonable cause relief may also be available to taxpayers who did receive relief under Notice 2001-

61 or this notice but who nevertheless could not meet their tax obligations within the relief period. A request for relief from penalties for reasonable cause should be attached to the return with an explanation of the reasons supporting relief. If penalties are assessed, Form 843, Claim for Refund and Request for Abatement, may be completed as a request for reasonable cause relief from penalties.

A. Missing Taxpayers

Individuals missing as a result of the Terrorist Attack are affected taxpayers as defined in Notice 2001-61 under the term "victims of the crash." Thus, the relief granted by Notice 2001-61 and this notice applies to individuals missing as a result of the Terrorist Attack.

B. Postponement of Deadlines for I.R.C. §1031 Exchanges

As explained below, a 120-day postponement of time is granted to affected taxpayers for the acts listed in Rev. Proc. 2001- 53, 2001-47 IRB 506 (November 19, 2001), if the last day to perform the act would otherwise fall within the period beginning on September 11, 2001, and ending on November 30, 2001. One of the acts listed in Rev. Proc. 2001-53 is an exchange of property under I.R.C. §1031. This notice provides three types of postponements relating to I.R.C. §1031 exchanges.

1. If the taxpayer (transferor) is an **affected taxpayer** under Notice 2001-61, **then the last day of the identification period or the exchange period** set forth in Treas. Reg. §1.1031(k)-1(b)(2), relating to deferred like-kind exchanges, or the last day of any period set forth in §4.02(3) through (6) of Rev. Proc. 2000-37, 2000-40 IRB 308 (October 2, 2000), relating to a qualified exchange accommodation arrangement, **is postponed by 120 days if the following requirements are met:**

   a. The relinquished property was transferred on or before September 11, 2001, or, in a transaction governed by Rev. Proc. 2000-37, property was transferred to the exchange accommodation titleholder on or before September 11, 2001; and

   b. Absent application of this notice, the identification period or the exchange period, or any time period set forth in section 4.02(3) through (6) of Rev. Proc. 2000-37, would end on or after September 11, 2001, and on or before November 30, 2001.

2. If a taxpayer (transferor) is **not** an affected taxpayer under Notice 2001-61, then **the last day of the identification period or the exchange period** set forth in Treas. Reg. §1.1031(k)-1(b)(2), or the last day of any period set forth in §4.02(3) through (6) of Rev. Proc. 2000-37, **is postponed by 120 days if the following requirements are met:**

   a. The relinquished property was transferred on or before September 11, 2001, or, in a transaction governed by Rev. Proc. 2000-37, property was transferred to the exchange accommodation titleholder on or before September 11, 2001; and

   b. Absent application of this notice, the identification period or the exchange period, or any time period set forth in section 4.02(3) through (6) of Rev. Proc. 2000-37, would end on or after September 11, 2001, and on or before November 30, 2001, and

   c. It is difficult to meet a deadline set forth in Treas. Reg. §1.1031(k)-1(b), or a deadline in §4.02(3) through (6) of Rev. Proc. 2000-37, due to the Terrorist Attack for the following or similar reasons:

   (I) The relinquished property or the replacement property is or was located in a covered disaster area (as defined in Notice 2001-61); or

   (II) The principal place of business of any party to the transaction other than the transferor (e.g., a qualified intermediary, exchange accommodation titleholder, transferee, settlement attorney, lender, financial institution, or a title insurance company) is located in a covered disaster area (as defined in Notice 2001-61); or

   (III) Any party to the transaction other than the transferor (or an employee of such a party who is or was involved in the I.R.C. §1031 transaction) was killed, injured, or is missing as a result of the Terrorist Attack; or

   (IV) A document prepared in connection with the exchange (e.g., the agreement between the transferor and the qualified intermediary or the deed to the relinquished property or replacement property) or land records were destroyed, damaged, or lost as a result of the Terrorist Attack; or

   (V) A lender decided not to fund a real estate closing due to the Terrorist Attack or refused to fund a loan to the taxpayer because terrorism insurance was not available; or

   (VI) A title insurance company was not able to provide the required title insurance policy necessary to settle or close a real estate transaction due to the Terrorist Attack.

3. If a postponement is not otherwise granted under paragraphs (1) and (2), a postponement

to September 24, 2001, similar to the postponement provided in Notice 2001-63, 2001-40 IRB 308 (October 1, 2001), is granted if the following requirements are met:

a. The relinquished property was transferred on or before September 11, 2001, or, in a transaction governed by Rev. Proc. 2000-37, property was transferred to the exchange accommodation titleholder on or before September 11, 2001; and

b. Absent application of this notice, the identification period or the exchange period, or any time period set forth in §4.02(3) through (6) of Rev. Proc. 2000-37, would end on or after September 11, 2001, and on or before September 17, 2001.

C. Additional Grant of Relief

1. This notice expands the relief provided by paragraph (2) of the Grant of Relief section of Notice 2001-61. The additional relief is for tax returns on an extension (not on a postponement under I.R.C. §7508A) that expires on or after December 1, 2001, and on or before January 31, 2002. For these returns, **the last date for filing the return is postponed until February 15, 2002,** under I.R.C. §7508A. **This additional relief is available only to taxpayers that have difficulty in meeting their federal tax obligations because their records, computers, or other essential supporting services were lost or damaged, or essential personnel were injured or killed, or are missing as a result of the Terrorist Attack.**

2. Under paragraph (4) of the Grant of Relief section of Notice 2001-61, the IRS granted to all affected taxpayers a 120-day postponement of time to perform the acts described in Treas. Reg. §301.7508A-1(c)(1), if the last day to perform the act fell within the period beginning on September 11, 2001, and ending on November 30, 2001. One of these acts is the filing of any Tax Court petition. Under this notice, the relief provided by paragraph (4) is expanded as follows. If the last date for filing any Tax Court petition would otherwise be on or after December 1, 2001, and on or before December 31, 2001, the last date for filing the petition is postponed by 60 days under I.R.C. §7508A.

3. In addition to the acts specifically identified in Treas. Reg. §301.7508A-1(c)(1), a 120-day postponement is granted for each act listed in Rev. Proc. 2001-53, for affected taxpayers if the last day to perform the act would otherwise fall within the period beginning on September 11, 2001, and ending on November 30, 2001. This postponement does not, however, apply to the acts required by I.R.C. §148(f)(3) and Treas. Reg. §1.148-3(g), Treas. Reg. §1.148-5(c), I.R.C. §148(f)(4)(C)(xvi) and Treas. Reg. §1.148-7(k)(1), or I.R.C. §149(e). Postponements of these acts for issuers of tax-exempt bonds were provided in Announcement 2001-101, 2001-43 IRB 374 (October 22, 2001). For purposes of tax-exempt bonds, the term "affected taxpayer" shall include any affected issuer as described in Announcement 2001-101. This postponement also does not apply to the deadline for Form 5500 and Form 5500-EZ filings. The Department of Labor's Pension and Welfare Benefits Administration Press Release No. 01-36 (released September 14, 2001) grants relief extending the deadline for filing Form 5500 and Form 5500-EZ.

D. Partners, S Corporation Shareholders, and Beneficiaries of Trusts and Estates

Partners, S corporation shareholders, and beneficiaries of trusts and estates use the information reported to them on Schedule K-1 by their partnerships, corporations, trusts, or estates to prepare their own income tax returns. If the income tax return of the partnership, S corporation, trust, or estate was postponed or extended under this notice or Notice 2001-61, the partner, S corporation shareholder, or beneficiary of a trust or estate may not receive the Schedule K-1 prior to the due date or extended due date of the partner's, shareholder's, or beneficiary's income tax return. **The income tax return of the partner, shareholder, or beneficiary is not postponed or extended by Notice 2001-61 or this notice solely because the entity (the partnership, S corporation, trust, or estate) is an affected taxpayer.**

> **Practitioner Note.** See Announcement 2001-124 on page 30 of this supplement for relief for partners, shareholders, and beneficiaries of trusts and estates.

Partners, shareholders, and beneficiaries of trusts and estates may request extensions of time to file their income tax returns. See I.R.C. §6081. If the Schedule K-1 is not received by the extended due date, the partner, shareholder, or beneficiary should prepare and file the income tax return on a timely basis by making a reasonable estimate in good faith of items of income, gain, loss, deduction, and credit attributable to the taxpayer's interest in the entity. Later, when the Schedule

K-1 is received, the taxpayer should prepare an amended return reflecting the items reported on the Schedule K-1. If the taxpayer's original return underestimated items of income or gain, or overstated items of deduction, loss, or credit, and a late payment penalty attributable to these items is assessed, the taxpayer should request an abatement of the penalty for reasonable cause. If the original return was prepared in good faith based on reasonable estimates of the tax items attributable to the entity, the IRS will waive or abate penalties for late payment.

E. Relief from Penalty for Failing to File Partnership Return by Magnetic Media

Any partnership that is an affected taxpayer, as defined in Notice 2001-61 and this notice, and that is required to file a partnership return by magnetic media (electronically) under I.R.C. §6011(e) will not be assessed a penalty under I.R.C. §6721 for failing to file the partnership return electronically if the partnership elects to file a paper return. This relief is for partnership returns that have an original due date or extended due date (not a postponed due date under I.R.C. §7508A) on or after September 11, 2001, and on or before November 30, 2001. Taxpayers who qualify should write "September 11, 2001 Terrorist Attack" in red ink on the top of their paper Form 1065. The IRS will abate any penalty that is improperly assessed.

F. Acts Performed by the Government

1. If the last date otherwise prescribed by law for making a tax assessment is on or after November 2, 2001, and the taxpayer received a 120-day postponement of time to file a Tax Court petition under paragraph (4) of the Grant of Relief section of Notice 2001-61, then the last date otherwise prescribed by law for making an assessment is correspondingly postponed by 120 days. This additional time for making an assessment is needed for the following reason. Under I.R.C. §6503, the period of limitations on assessment is suspended when a statutory notice of deficiency is mailed. The I.R.C. §6503 suspension period (generally 150 days) includes the period (generally 90 days) after the issuance of a statutory notice of deficiency during which the taxpayer is permitted to file a Tax Court petition and the IRS is prohibited from making an assessment. See I.R.C. §§6213(a) and 6213(c). Under Notice 2001-61, affected taxpayers are entitled to an additional 120 days to file a Tax Court petition in response to the notice of deficiency. In some cases, the period of limitations on assessment could expire prior to the expiration of the expanded period during which an affected taxpayer may file a Tax Court petition.

2. Similar to paragraph (1), if the last date otherwise prescribed by law for making a tax assessment is on or after November 2, 2001, and the taxpayer receives a 60-day postponement of time to file a Tax Court petition under paragraph (2) of the Additional Grant of Relief section of this notice, the last date otherwise prescribed by law for making a tax assessment is correspondingly postponed by 60 days.

3. Documents maintained by the IRS (including the Office of Chief Counsel) in New York City were destroyed or lost in the Terrorist Attack, or remain in buildings that are inaccessible. The destruction or loss of these documents (or the IRS's lack of access to them) will materially interfere with the IRS's ability to timely administer the Internal Revenue Code with respect to certain taxpayers. The taxpayers to whom these records relate are "affected taxpayers" for the limited purpose of this paragraph. In these cases, a 120-day postponement is granted for the following government acts if the last date for performance of the act is on or after November 2, 2001, and on or before November 30, 2001: making an assessment of any tax; issuing a statutory notice of deficiency; allowing a credit or refund of any tax; collecting by the Secretary, by levy or otherwise, the amount of any liability in respect of any tax; bringing suit by the United States, or any office on its behalf, in respect of any tax liability; returning property under I.R.C. §6343; and the discharge of an executor from personal liability for a decedent's taxes under I.R.C. §6905. The IRS will notify, as soon as practicable, any affected taxpayers, as defined under this paragraph, of the government act or acts that will be postponed.

G. Taxpayer Inquiries

If you wish to recommend that other acts qualify for postponement under this notice, Notice 2001-61, or Rev. Proc. 2001- 53, please write to the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division), CC:PA:APJP:Br2, 1111 Constitution Avenue, NW, Washington, DC 20224, or send an e-mail message to Notice.Comments@irscounsel.treas.gov. Please write "7508A List" on the envelope or in the subject matter area of the e-mail.

[Notice 2001-68, 2001-47 IRB 504]

Rev. Proc. 2001-53
[I.R.C. §§7508 and 7508A]

> ☞ **An extensive list of acts by taxpayers who are either serving in Armed Forces or who are affected by Presidentially declared disaster that may be postponed under I.R.C. §7508 or I.R.C. § 7508A is provided.**

Purpose. This revenue procedure provides a list of time-sensitive acts, the performance of which may be postponed under I.R.C. §§7508 and 7508A. I.R.C. §7508 postpones specified acts for individuals serving in the Armed Forces of the United States or serving in support of such Armed Forces in a combat zone. I.R.C. §7508A permits a postponement of specified acts for taxpayers affected by a Presidentially declared disaster. The list of acts in this revenue procedure supplements the list of postponed acts in I.R.C. §7508(a)(1) and Treas. Reg. §301.7508A-1(b).

This revenue procedure does not, by itself, provide any postponements under I.R.C. §§7508 or 7508A. In order for taxpayers to be entitled to a postponement of any act listed in this revenue procedure, the IRS generally will publish a Notice or other guidance providing relief with respect to a specific combat zone or Presidentially declared disaster.

This revenue procedure will be updated as needed when the IRS determines that additional acts should be included in the list of postponed acts or that certain acts should be removed from the list. Also, taxpayers may recommend that additional acts be considered for postponement under I.R.C. §§7508 and 7508A. See section 17 of this revenue procedure.

Scope. This revenue procedure applies to individuals serving in the Armed Forces in a combat zone, or in support of such Armed Forces, and to affected taxpayers within the meaning of Treas. Reg. §301.7508A-1(d)(1).

Application. The Revenue Procedure includes tables that list sections of the Internal Revenue Code and Treasury Regulations requiring the timely performance of specified acts that may be postponed under I.R.C. §§7508 and 7508A.

In order to avoid unnecessary duplication, the tables do not include acts specified in I.R.C. §§7508 or 7508A or the regulations thereunder. Thus, for example, no mention is made in the tables of the filing of tax returns or the payment of taxes (or an installment thereof) because these acts are already covered by I.R.C. §§7508 and 7508A and the regulations thereunder. Also, the tables do not refer to the making of accounting method elections or any other elections required to be made on tax returns or attachments thereto. Reference to these elections is not necessary because postponement of the filing of a tax return automatically postpones the making of any election required to be made on the return or an attachment thereto.

The tables refer only to postponement of acts performed by taxpayers. Additional guidance will be published in the Internal Revenue Bulletin if a decision is made that acts performed by the government may be postponed under I.R.C. §7508 or I.R.C. §7508A.

The tables are arranged under the following headings:

- Accounting Methods and Periods
- Business and Individual Tax Issues
- Corporate Issues
- Employee Benefit Issues
- Estate, Gift, and Trust Issues
- Exempt Organization Issues
- Excise Tax Issues
- International Issues
- Partnership and S Corporation Issues
- Procedure & Administration Issues
- Tax Credit Issues
- Tax-Exempt Bond Issues

If you wish to recommend that other acts qualify for postponement, please write to the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division), CC:PA:APJP:B2, 1111 Constitution Avenue, NW, Washington, DC 20224. Please mark "7508A List" on the envelope. In the alternative, e-mail your comments to: Notice.Comments@m1.irscounsel.treas.gov.

[Rev. Proc. 2001-53, 2001-47 IRB 506]

Announcement 2001-124
[I.R.C. §§6081; 6161; and 7508A]

> ☞ **Taxpayer that is partner, shareholder, or beneficiary of taxpayer affected by September 11, 2001 terrorist attacks is also "affected taxpayer," for purposes of relief granted by earlier rulings.**

This announces additional relief in connection with the September 11, 2001, terrorist attack for partners, shareholders, and beneficiaries of passthrough entities that are affected taxpayers as defined in Notice 2001-61, 2001-40 IRB 305 (October 1, 2001). This announcement modifies and expands the relief granted by Announcement 2001-117. Under Treas.

Reg. §301.7508A-1(d)(1)(vii) the IRS may determine whether any person is affected by a Presidentially declared disaster. **The IRS has determined that a taxpayer that is a partner, shareholder, or beneficiary of a taxpayer affected by the September 11, 2001, terrorist attack, is also an affected taxpayer.** Accordingly, partners, shareholders, and beneficiaries of an affected taxpayer are eligible for all the relief granted by Notice 2001-61 and Notice 2001-68. Thus, for example, a partner that is an individual income taxpayer with an extended due date of October 15, 2001, for the 2000 return will have until February 12, 2002, to file the return.

If a partner, shareholder, or beneficiary of an affected taxpayer qualifies for relief under this notice because an original due date fell within the specified period, and such partner, shareholder, or beneficiary has already obtained an extension of time to file, the IRS will supplement such extension with the relief granted by Notice 2001-61 and/or Notice 2001-68. Thus, for example, a corporate partner with an original due date during the specified period that has obtained the automatic 6-month extension of time to file will be granted a 6-month extension of time to pay and an additional 120-day postponement of time to file and time to pay.

Taxpayers that qualify for relief under this announcement should mark "September 11, 2001, Terrorist Attacks–Passthrough Entity" in red ink on the top of their returns or other documents filed with the IRS.

[Announcement 2001-124, 2001-52 IRB ___]

TRAVEL AND TRANSPORTATION

Rev. Proc. 2001-47
[I.R.C. §274]

> ☞ **Per diem rates for traveling expenses and meals are updated for the last three months of 2001 and some changes are made to the list of high-cost localities.**

This revenue procedure updates Rev. Proc. 2000-39, 2000-41 IRB 340, by providing rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home will be deemed substantiated under Treas. Reg. §1.274-5 when a payor (the employer, its agent, or a third party) provides a per diem allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. This revenue procedure also provides an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. Use of a method described in this revenue procedure is not mandatory, and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. This revenue procedure does not provide rules under which the amount of an employee's lodging expenses will be deemed substantiated when a payor provides an allowance to pay for those expenses but not meal and incidental expenses.

Specific High-Low Rates. **The per diem rate is $204** (up $3 from the rate announced in Rev. Proc. 2000-39) **for travel to any "high-cost locality"** specified in this revenue procedure, **or $125** (up $1 from the rate announced in Rev. Proc. 2000-39) **for travel to any other locality within CONUS.** Whichever per diem rate applies, it is applied as if it were the federal per diem rate for the locality of travel. For purposes of applying the high-low substantiation method and the I.R.C. §274(n) limitation on meal expenses, **the federal M&IE rate shall be treated as $42 for a high-cost locality and $34 for any other locality within CONUS.**

Changes in High-Cost Localities. The list of high-cost localities in section 5.03 of this revenue procedure differs from the list of high-cost localities in section 5.03 of Rev. Proc. 2000-39.

1. The following localities (listed by key cities) have been added to the list of high-cost localities: Napa, California; San Mateo/Redwood City, California; Palm Beach, Florida; Kennebunk/Kittery/Sanford, Maine; Nantucket, Massachusetts; Stateline, Nevada; Atlantic City, New Jersey; Edison, New Jersey; Newark, New Jersey; Ogden/Layton/Davis County, Utah; Provo, Utah; and Salt Lake City, Utah.

2. The portion of the year for which the following are high- cost localities (listed by key cities) has been changed: Telluride, Colorado; Vail, Colorado; Big Sky, Montana; and Park City, Utah.

3. The following locality has been removed from the list of high-cost localities: Philadelphia, Pennsylvania.

[Rev. Proc. 2001-47, 2001-42 IRB 332]

2001 Workbook