

HIGHLIGHTS OF THIS ISSUE

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

SPECIAL ANNOUNCEMENT

Notice 2009-43, page 1037.

The Department of Treasury and the Service invite public comments on recommendations for items that should be included on the 2009-2010 Guidance Priority List. Taxpayers may submit recommendations for guidance at any time during the year. Recommendations submitted by May 31, 2009, will be reviewed for possible inclusion on the original 2009-2010 Guidance Priority List. Recommendations received after May 31, 2009, will be reviewed for inclusion in the next periodic update.

INCOME TAX

Rev. Rul. 2009-13, page 1029.

Primary sale of life insurance contract; tax treatment of a sale or surrender. This ruling provides guidance to policyholders who surrender or sell their life insurance contracts.

Rev. Rul. 2009-14, page 1031.

Secondary sale of life insurance contract by investors. This ruling provides guidance to investors who purchase life insurance contracts.

Rev. Rul. 2009-15, page 1035.

Formless conversion of partnership to S corporation. This ruling explains that a partnership that converts to a corporation under either regulations section 301.7701-3(c)(1)(i) or under a state law formless conversion statute is allowed to make an S election effective for the corporation's first taxable year.

Notice 2009-44, page 1037.

This notice clarifies that, under regulations section 1.42-10 (the utility allowance regulations), utility costs paid by a tenant based on actual consumption in a sub-metered rent-restricted unit are treated as paid directly by the tenant for purposes of section 42(g)(2)(B)(ii) of the Code.

ADMINISTRATIVE

Announcement 2009-45, page 1040.

This document contains corrections to final regulations (T.D. 9446, 2009-9 I.R.B. 607) concerning gain recognition agreements filed by United States persons with respect to transfers of stock or securities to foreign corporations.

Announcements of Disbarments and Suspensions begin on page 1040.
Finding Lists begin on page ii.
Index for January through May begins on page vi.



The IRS Mission

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

the tax law with integrity and fairness to all.

Introduction

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

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

(Also §§ 1001, 1011, 1012, 1221, and 1234A.)

Primary sale of life insurance contract; tax treatment of a sale or surrender. This ruling provides guidance to policyholders who surrender or sell their life insurance contracts.

Rev. Rul. 2009-13

ISSUE

What is the amount and character of A's income recognized upon the surrender or sale of the life insurance contracts described in the situations below?

FACTS

Situation 1

On January 1 of Year 1, A, an individual, entered into a "life insurance contract" (as defined in § 7702 of the Internal Revenue Code (Code)) with cash value. Under the contract, A was the insured, and the named beneficiary was a member of A's family. A had the right to change the beneficiary, take out a policy loan, or surrender the contract for its cash surrender value. The contract in A's hands was not property described in § 1221(a)(1)–(8).

On June 15 of Year 8, A surrendered the contract for its \$78,000 cash surrender value, which reflected the subtraction of \$10,000 of "cost-of-insurance" charges collected by the issuer for periods ending on or before the surrender of the contract. Through that date, A had paid premiums totaling \$64,000 with regard to the life insurance contract. A had neither received any distributions under the contract nor borrowed against the contract's cash surrender value.

A determines taxable income using the cash method of accounting and files income tax returns on a calendar year basis. As of June 15 of Year 8, A was not a terminally ill individual, nor a chronically ill individual, within the meaning of § 101(g)(4).

Situation 2

The facts are the same as in Situation 1, except that on June 15 of Year 8, A sold the life insurance contract for \$80,000 to B, a person unrelated to A and who would suffer no economic loss upon A's death.

Situation 3

The facts are the same as in Situation 1, except that the contract was a level premium fifteen-year term life insurance contract without cash surrender value. The monthly premium for the contract was \$500. Through June 15 of Year 8, A paid premiums totaling \$45,000 with regard to the contract. On June 15 of Year 8, A sold the life insurance contract for \$20,000 to B, a person unrelated to A and who would suffer no economic loss upon A's death.

LAW AND ANALYSIS

SITUATION 1

Amount of income recognized upon surrender of the life insurance contract

Section 61(a) provides that, except as otherwise provided in the income tax provisions of the Code, gross income includes all income from whatever source derived, including (but not limited to) income from life insurance contracts. See § 61(a)(10). To the extent that another section of the Code or regulations provides specific treatment of any item of income, that other provision applies notwithstanding § 61 and the regulations thereunder. See § 1.61-1(b) of the Income Tax Regulations.

Section 72(e) governs the federal income tax treatment of amounts received under an annuity, endowment, or life insurance contract that are not received as an annuity. In general, under § 72(e)(2), a non-annuity amount that is received on or after the annuity starting date is included in gross income. If a non-annuity amount is received before the annuity starting date, it is included in gross income to the extent allocable to income on the contract, but not to the extent allocable to investment in the contract (*i.e.*, it is taxed on an income-first basis).

Section 72(e)(5) provides an exception to the income-first rule in the case of –(1) certain contracts including, under § 72(e)(5)(C), life insurance contracts other than a "modified endowment contract" (as defined in § 7702A) and (2) any non-annuity amount received under a contract on its complete surrender, redemption, or maturity.

If a non-annuity amount is received under a life insurance contract other than a modified endowment contract before the annuity starting date, or is received under a life insurance contract on the complete surrender, redemption, or maturity of the contract, § 72(e)(5)(A) requires that the amount be included in gross income but only to the extent it exceeds investment in the contract. For this purpose, § 72(e)(6) defines "investment in the contract" as of any date as the aggregate amount of premiums or other consideration paid for the contract before that date, less the aggregate amount received under the contract before that date to the extent that amount was excludable from gross income.

In Situation 1, A received \$78,000 on the complete surrender of a life insurance contract. A's income upon surrender of the contract is determined under § 72(e)(5). Under § 72(e)(5)(A), the amount received is included in gross income to the extent it exceeds the investment in the contract. As A paid aggregate premiums of \$64,000 with regard to the contract, and neither received any distributions under the contract nor borrowed against the contract's cash surrender value prior to surrender, A's "investment in the contract" as required by § 72(e)(6) was \$64,000. Consequently, pursuant to § 72(e)(5)(A), A recognized \$14,000 of income on surrender of the contract, which is the excess of \$78,000 received over \$64,000.

Character of income recognized upon surrender of the life insurance contract

Section 72(e) does not specify whether income recognized upon the surrender of a life insurance contract is treated as ordinary income or as capital gain. Thus, the character of the income that A recognized on the surrender of the life insurance

contract is capital gain only if it so qualifies under the general rules of subchapter P (§§ 1201–1260).

Section 1222(3) defines long-term capital gain as gain from the sale or exchange of a capital asset held for more than one year, if and to the extent such gain is taken into account in computing gross income. Section 1221(a) provides that the term “capital asset” means property held by the taxpayer (whether or not connected with a trade or business), but does not include items described in § 1221(a)(1)–(8). As noted above, the life insurance contract was not property described in § 1221(a)(1)–(8).

The surrender of a life insurance contract does not, however, produce a capital gain. *See, e.g.*, Rev. Rul. 64–51, 1964–1 C.B. 322 (noting that “[u]nder section 61(a)(10) of the Code, the proceeds received by an insured upon the surrender of, or at maturity of, a life insurance policy constitutes ordinary income to the extent such proceeds exceed the cost of the policy”). Section 1234A, originally enacted in 1981, does not change this result.

Accordingly, in Situation 1 the \$14,000 of income recognized by A on the surrender of the life insurance contract is ordinary income.

SITUATION 2

Amount of income recognized on sale of the life insurance contract

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain realized from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain. Thus, to determine the amount of A’s income from the sale of the life insurance contract in Situation 2, it is necessary to determine A’s amount realized from the sale, and A’s adjusted basis in the contract.

Pursuant to § 1001(b), A’s amount realized from the sale of the life insurance contract is the sum of money received from the sale, or \$80,000.

Under §§ 1011 and 1012, the adjusted basis for determining gain or loss is generally the cost of the property adjusted as provided in § 1016, except

as otherwise provided in subchapters O (§§ 1011 through 1092), C (§§ 301 through 386), K (§§ 701 through 777), and P (§§ 1201 through 1298). *See also* § 263(a); § 1.263(a)–4. Under § 1016(a)(1), proper adjustment must be made for expenditures, receipts, losses, or other items properly chargeable to capital account. *See also* § 1.1016–2(a). Section 72 has no bearing on the determination of the basis of a life insurance contract that is sold, because § 72 applies only to amounts received under the contract.

Both the Code and the courts acknowledge that a life insurance contract, although a single asset, may have both investment characteristics and insurance characteristics. *See, e.g.*, § 7702 (defining life insurance contract for federal income tax purposes by reference, in part, to both the cash surrender value and death benefits under the contract); *London Shoe Co. v. Commissioner*, 80 F.2d 230, 231 (2d Cir. 1935) (“A life insurance policy ordinarily combines investment with insurance protection.”); *Century Wood Preserving Co. v. Commissioner*, 69 F.2d 967, 968 (3d Cir. 1934) (“The policies of insurance involved here have a double aspect. They provide the present protection of ordinary life insurance and also a means of investment.”). To measure a taxpayer’s gain upon the sale of a life insurance contract, it is necessary to reduce basis by that portion of the premium paid for the contract that was expended for the provision of insurance before the sale.

In *Century Wood Preserving Co. v. Commissioner*, 69 F.2d 967 (3d Cir. 1934), a corporate taxpayer paid \$98,242 of premiums on life insurance contracts over a period of several years to insure the lives of its officers. The taxpayer then sold the contracts to the officers for their cash surrender value of \$57,646, claiming a loss for the difference between the total premiums paid and the amount for which it sold the contracts. The court held that the taxpayer did not have a loss, because it did not have a basis equal to the full amount of the premiums paid:

If the [taxpayer] is entitled to a deduction from gross income, it is because [it has] sustained a loss, the basis of determining which is the cost of the property. . . . The cost of an asset is the real question here. It is obvious that cost is not the total amount paid in as premiums,

since continuing insurance protection is part of the consideration for the contract. The part of the premiums which represents annual insurance protection has been earned and used. 69 F.2d at 968.

See also London Shoe Co., 80 F.2d at 233 (noting, in the context of a situation in which the policy was surrendered, not sold, that “the cost [of the policy] was approximately reflected in the cash surrender value . . . [t]he portion of the premiums not used to build up the reserve was paid to obtain insurance protection which was for many years afforded.”); *Keystone Consolidated Publishing Co. v. Commissioner*, 26 B.T.A. 1210, 1211 (1932) (stating “[t]otal premiums paid did not represent the cost of the [life insurance contract]. . . . [t]o so hold would be to disregard the element of insurance protection in the period prior to the sale, the benefit of which accrued to petitioner.”); § 1.1016–2(a) (cost or other basis of property adjusted for any expenditures, receipts, losses or other items properly chargeable to capital account). *Compare* Rev. Rul. 2009–14, page 1031, this Bulletin (not requiring a reduction for cost of insurance charges imposed after a preexisting life insurance contract was purchased for profit by a taxpayer with no insurable interest in the insured).

In Situation 2, A paid total premiums of \$64,000 under the life insurance contract through the date of sale, and \$10,000 was subtracted from the contract’s cash surrender value as cost-of-insurance charges. Accordingly, A’s adjusted basis in the contract as of the date of sale under §§ 1011 and 1012 and the authorities cited above was \$54,000 (\$64,000 premiums paid less \$10,000 expended as cost of insurance).

Accordingly, A must recognize \$26,000 on the sale of the life insurance contract to B, which is the excess of the amount realized on the sale (\$80,000) over A’s adjusted basis of the contract (\$54,000).

Character of income recognized on sale of the life insurance contract

Unlike Situation 1, which involves the surrender of the life insurance contract to the issuer of the contract, Situation 2 involves an actual sale of the contract. Nevertheless some or all of the gain on the

sale of the contract may be ordinary if the substitute for ordinary income doctrine applies.

The Supreme Court has held, under the so-called “substitute for ordinary income” doctrine, that “property” within the meaning of § 1221 does not include claims or rights to ordinary income. Instead, the Court “has consistently construed ‘capital asset’ to exclude property representing income items or accretions to the value of a capital asset themselves properly attributable to income.” *United States v. Midland-Ross Corp.*, 381 U.S. 54, 57 (1965). See also *Commissioner v. P.G. Lake, Inc.*, 356 U.S. 260 (1958) (consideration received on the sale of a working interest in an oil well represented a substitute for what would have been received in the future as ordinary income, therefore taxable as ordinary income and not capital gain); *Arkansas Best Corp. v. Commissioner*, 485 U.S. 212, 217, n.5 (1988) (noting that the “substitute for ordinary income” doctrine had no application to that case). Thus, ordinary income that has been earned but not recognized by a taxpayer cannot be converted into capital gain by a sale or exchange. See also *Prebola v. Commissioner*, 482 F.3d 610 (2d Cir. 2007); *United States v. Maginnis*, 356 F.3d 1179 (9th Cir. 2004); *Davis v. Commissioner*, 119 T.C. 1 (2002) (applying the “substitute for ordinary income” doctrine after the *Arkansas Best* decision).

The “substitute for ordinary income” doctrine has been applied to characterize the profit on a sale of an annuity contract or life insurance contract as ordinary income. For example, in *Gallun v. Commissioner*, 327 F.2d 809, 811 (7th Cir. 1964), the court stated:

The question presented has been considered by other courts. Uniformly, they have held that the assignment of income doctrine . . . should be applied and the profits realized from the sale or the surrender value of an annuity or life insurance contract should be treated as ordinary income rather than capital gain. These cases are: *First Nat’l Bank of Kansas City v. Commissioner*, 309 F.2d 587 (8th Cir. 1962); *Rolf v. Commissioner*, 304 F.2d 450 (3d Cir. 1962); *Commissioner v. Phillips*, 275 F.2d 33 (4th Cir. 1960); *Arnfeld v. United*

States, 163 F. Supp. 865, 143 Ct. Cl. 277 (1958).

Application of the “substitute for ordinary income” doctrine is limited to the amount that would be recognized as ordinary income if the contract were surrendered (*i.e.*, to the inside build-up under the contract). Hence, if the income recognized on the sale or exchange of a life insurance contract exceeds the “inside build-up” under the contract, the excess may qualify as gain from the sale or exchange of a capital asset. See, *e.g.*, *Commissioner v. Phillips*, 275 F.2d 33, 36 n. 3 (4th Cir. 1960).

In Situation 2, the inside build-up under A’s life insurance contract immediately prior to the sale to B was \$14,000 (\$78,000 cash surrender value less \$64,000 aggregate premiums paid). Hence, \$14,000 of the \$26,000 of income that A must recognize on the sale of the contract is ordinary income under the “substitute for ordinary income” doctrine. Because the life insurance contract in A’s hands was not property described in § 1221(a)(1)–(8) and was held by A for more than one year, the remaining \$12,000 of income is long-term capital gain within the meaning of § 1222(3).

SITUATION 3

Amount of income recognized on sale of the term life insurance contract

In Situation 3, the amount realized from the sale of the term life insurance contract is the sum of money received from the sale, or \$20,000.

A’s adjusted basis in the life insurance contract for purposes of determining its gain or loss on sale is equal to the total premiums paid under the contract, less charges for the provision of insurance before the sale. Absent other proof, the cost of the insurance provided to A each month is presumed to equal the monthly premium under the contract, or \$500. The cost of the insurance protection provided to A during the 89.5 month period that A held the contract was \$500 times 89.5 months, or \$44,750. Hence, A’s adjusted basis in the contract on the date of the sale to B was \$250 (\$45,000 total premiums paid, less \$44,750 cost of insurance protection).

Accordingly, A must recognize \$19,750 on the sale of the term life insurance contract to B in Situation 3, which is the excess of the amount realized on the sale

(\$20,000) over the adjusted basis of the contract (\$250).

Character of income recognized on sale of the term life insurance contract

In Situation 3, the term life insurance contract had no cash surrender value. Hence, there was no inside buildup under the contract to which the substitute for ordinary income doctrine could apply. Because the life insurance contract in A’s hands was not property described in § 1221(a)(1)–(8) and was held by A for more than one year, the \$19,750 of income that A must recognize on the sale of the contract is long-term capital gain within the meaning of § 1222(3).

HOLDINGS

1. In Situation 1, A must recognize \$14,000 of ordinary income upon surrender of the life insurance contract.

2. In Situation 2, A must recognize \$26,000 of income upon sale of the life insurance contract. Of this \$26,000 of income, \$14,000 is ordinary income, and \$12,000 is long-term capital gain.

3. In Situation 3, A must recognize \$19,750 of long-term capital gain upon sale of the life insurance contract.

EFFECTIVE DATE

Under the authority of § 7805(b)(8), the holdings of this revenue ruling with respect to Situations 2 and 3 will not be applied adversely to sales occurring before August 26, 2009.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Josephine H. Firehock of the Office of Associate Chief Counsel (International) and Stephen D. Hooe of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this ruling, contact Stephen D. Hooe at (202) 622-7595 (not a toll-free call).

Section 101.—Certain Death Benefits

(Also §§ 263, 865, 1001, 1011, 1012, and 1221.)

Secondary sale of life insurance contract by investors. This ruling provides

guidance to investors who purchase life insurance contracts.

Rev. Rul. 2009-14

ISSUE

What are the tax consequences to *B*, in the situations described below, upon the receipt of death benefits, or upon the receipt of sale proceeds, with regard to a term life insurance contract that *B* purchased for profit?

FACTS

Situation 1

A is a United States citizen residing in the United States. *B* is a United States person as defined in § 7701(a)(30) of the Internal Revenue Code (Code). *B* determines taxable income using the cash method of accounting and files its income tax returns on a calendar year basis.

On June 15, 2008, *B* purchased from *A* for \$20,000 a “life insurance contract” (as defined in § 7702) on the life of *A*. The contract was originally issued by *IC*, a domestic corporation, to *A* on January 1, 2001. The contract was a level premium fifteen-year term life insurance contract without cash surrender value. At the time of purchase, the remaining term of the contract was 7 years, 6 months, and 15 days. The monthly premium for the contract was \$500, due and payable on the first day of each month. As owner of the contract, *B* had the right to change the beneficiary and, pursuant to that right, named itself beneficiary under the contract immediately after acquiring the contract.

B had no insurable interest in *A*'s life and, except for the purchase of the contract, *B* had no relationship to *A* and would suffer no economic loss upon *A*'s death. *B* purchased the contract with a view to profit. The contract in *B*'s hands was not property described in § 1221(a)(1)–(8). The likelihood that *B* would allow the contract to lapse by failing to pay any of the remaining premiums was remote.

On December 31, 2009, *A* died, and *IC* paid \$100,000 under the life insurance contract to *B* by reason of *A*'s death. Through that date, *B* had paid monthly premiums totaling \$9,000 to keep the contract in force.

Situation 2

The facts are the same as in Situation 1, except that *A* did not die and, on December 31, 2009, *B* sold the contract to *C* (a person unrelated to *A* or *B*) for \$30,000.

Situation 3

The facts are the same as in Situation 1, except that *B* is a foreign corporation that is not engaged in a trade or business within the United States (including the trade or business of purchasing, or taking assignments of, life insurance contracts).

LAW AND ANALYSIS

SITUATION 1.

Amount of income recognized by B upon the receipt of death benefits

Section 61(a) provides that, except as otherwise provided in the income tax provisions of the Code, gross income includes all income from whatever source derived, including (but not limited to) income from life insurance contracts. See § 61(a)(10). To the extent that another section of the Code or regulations provides specific treatment of any item of income, that other provision applies notwithstanding § 61 and the regulations thereunder. See § 1.61-1(b) of the Income Tax Regulations.

Section 72(e) governs the federal income tax treatment of amounts received under an annuity, endowment, or life insurance contract that are not received as an annuity. In general, under § 72(e)(2), a non-annuity amount that is received on or after the annuity starting date is included in gross income. If a non-annuity amount is received before the annuity starting date, it is included in gross income to the extent allocable to income on the contract, but not to the extent allocable to investment in the contract (*i.e.*, it is taxed on an income-first basis).

Section 72(e)(5) provides an exception to the income-first rule in the case of –(1) certain contracts including, under § 72(e)(5)(C), life insurance contracts other than a “modified endowment contract” (as defined in § 7702A) and (2) any non-annuity amount received under a contract on its complete surrender, redemption, or maturity.

If a non-annuity amount is received under a life insurance contract other than a modified endowment contract before the annuity starting date, or is received under a life insurance contract on the complete surrender, redemption, or maturity of the contract, § 72(e)(5)(A) requires that the amount be included in gross income but only to the extent it exceeds investment in the contract. For this purpose, § 72(e)(6) defines “investment in the contract” as of any date as the aggregate amount of premiums or other consideration paid for the contract before that date, less the aggregate amount received under the contract before that date to the extent that amounts was excludable from gross income. In the case of a transferee for value, only the actual value of consideration paid for the contract, plus premiums and other consideration paid after the transfer, is taken into account. See generally § 72(g); § 1.72-10.

Section 101(a)(1) provides, generally, that gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured. In the case of a transfer for valuable consideration, however, § 101(a)(2) provides that the amount excluded from gross income shall not exceed an amount equal to the sum of the actual value of the consideration paid and the premiums and other amounts subsequently paid by the transferee. The “transfer for value” rule of § 101(a)(2) does not apply in the case of a transfer involving a carryover basis or in the case of a transfer to the insured, a partner of the insured, a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.

In Situation 1, *B* received \$100,000 from *IC* by reason of the death of *A*, the insured under the contract. Because *B* purchased the contract from *A* in exchange for a purchase price of \$20,000, *B*'s acquisition of the contract was a “transfer for a valuable consideration” within the meaning of § 101(a)(2). Neither the carryover basis exception of § 101(a)(2)(A) nor the exception for transfers involving parties related to the insured under § 101(a)(2)(B) applied. Accordingly, § 101(a)(1) excludes from *B*'s gross income the amount received by reason of *A*'s death, but § 101(a)(2) limits the exclusion to the sum of the actual value of the con-

sideration paid for the transfer (\$20,000) and other amounts paid by *B* (\$9,000), or \$29,000. *B* therefore must include in gross income \$71,000, which is the difference between the total death benefit received (\$100,000) and the amount excluded under § 101 (\$29,000).

Character of income recognized by B upon the receipt of death benefits

Neither § 61(a) nor § 72(e) specifies whether taxable amounts of death benefits received by a transferee for value of a life insurance contract by reason of the death of the insured are treated as ordinary income or as capital gain. Thus, the character of the income that *B* recognized upon receipt of death benefits under the contract is capital gain only if it so qualifies under the general rules of subchapter P (§§ 1201–1260).

Section 1222(3) defines long-term capital gain as gain from the sale or exchange of a capital asset held for more than one year if and to the extent such gain is taken into account in computing gross income. Section 1221(a) provides that the term “capital asset” means property held by the taxpayer (whether or not connected with a trade or business), but does not include items described in § 1221(a)(1)–(8). The life insurance contract in *B*’s hands was not property described in § 1221(a)(1)–(8), and was thus a capital asset in *B*’s hands.

Neither the surrender of a life insurance or annuity contract nor the receipt of a death benefit from the issuer under the terms of the contract produces a capital gain. Accordingly, the \$71,000 income recognized by *B* upon the receipt of death benefits under the contract is ordinary income.

SITUATION 2.

Amount of income recognized by B upon sale of life insurance contract

Section 1001(a) provides that the gain realized from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain. Thus, to determine the amount of *B*’s income from the sale of the life insurance contract to *C*, it is necessary to determine *B*’s amount realized from the sale, and *B*’s adjusted basis in the contract.

Pursuant to § 1001(b), *B*’s amount realized from the sale of the life insurance contract is the sum of money received from the sale, or \$30,000.

Under §§ 1011 and 1012, the adjusted basis for determining gain or loss is generally the cost of the property as adjusted provided in § 1016, except as otherwise provided in subchapters O (§§ 1011 through 1092), C (§§ 301 through 386), K (§§ 702 through 777), and P (§§ 1201 through 1298). Section 101(a)(2) has no bearing on the determination of the basis of a life insurance contract that is sold, because § 101(a)(2) applies only to amounts received by reason of the death of the insured.

The starting point for determining the basis of a life insurance contract for purposes of measuring gain on its sale is its cost. Section 1.263(a)–4(c)(1)(iv) requires taxpayers to capitalize an amount paid to another party to acquire an intangible (including a life insurance contract) from that party in a purchase or similar transaction. In Situation 2, *B* paid \$20,000 to *A* to acquire the life insurance contract from *A*, which is included in *B*’s cost basis.

In Situation 2, *B* also paid \$9,000 in monthly premiums to prevent the contract from lapsing. No deduction is allowed for these monthly premiums under section 264. However, § 1.263(a)–4(b)(1)(iv) authorizes the Service and Treasury to publish guidance in the Internal Revenue Bulletin that identifies a future benefit as an intangible for which capitalization is required. The premiums paid by a secondary market purchaser of a term life insurance contract serve to create or enhance a future benefit for which capitalization is appropriate. Accordingly, this revenue ruling requires a secondary market purchaser to capitalize premiums paid to prevent a term life insurance contract (without cash value) from lapsing. The Service will not challenge the capitalization of such premiums paid or incurred prior to the issuance of this ruling.

In Situation 2, *B* paid \$20,000 to acquire the life insurance contract and \$9,000 in monthly premiums to prevent the contract from lapsing. Therefore, *B*’s adjusted basis for purposes of measuring gain on the sale to *C* was \$29,000.

In Rev. Rul. 2009–13, page 1029, this Bulletin, Situation 2, a taxpayer paid premiums totaling \$64,000 with regard

to a life insurance contract, and \$10,000 of “cost of insurance” charges were subtracted from the contract’s cash surrender value. The taxpayer sold the contract for \$80,000. The ruling concludes that the taxpayer’s gain on the sale was equal to \$26,000, representing the \$80,000 amount realized less \$54,000 adjusted basis (\$64,000 total premiums paid minus \$10,000 cost of insurance charges). The ruling notes that on these facts, the reduction for cost of insurance charges is necessary to account for the insurance protection the taxpayer received before the sale. Similarly, in *Century Wood Preserving Co. v. Commissioner*, 69 F.2d 967 (3rd Cir. 1934), the court concluded that a taxpayer who sold a life insurance contract could not include in basis amounts that were used to provide annual insurance protection. See also *London Shoe Co. v. Commissioner*, 80 F.2d 230 (2d Cir. 1935); *Keystone Consolidated Publishing Co. v. Commissioner*, 26 B.T.A. 1210 (1932).

B is not required to reduce its basis in the life insurance contract by any cost of insurance charges that may have been imposed. In Rev. Rul. 2009–13, *Century Wood Preserving, London Shoe, and Keystone Consolidated*, adjusted basis was reduced by cost of insurance charges because those charges represented the cost of insurance protection that was enjoyed by the policyholder as the beneficiary of the policy. In contrast, in Situation 2, *B* is wholly unrelated to *A* and did not purchase the life insurance contract for protection against any economic loss upon *A*’s death. *B* acquired and held the contract solely with a view to profit, and paid additional premiums to prevent the lapse of *B*’s purely financial investment, the contract. Situation 2 is thus distinguishable from Rev. Rul. 2009–13 and the authorities cited therein.

As the amount realized on *B*’s sale of the life insurance contract to *C* was \$30,000, and the adjusted basis was \$29,000, *B* must recognize \$1,000 on the sale to *C* in Situation 2.

Character of income recognized by B upon sale of life insurance contract

Because the term life insurance contract was not property described in § 1221(a)(1)–(8) and was held for more than one year, the \$1,000 of gain recog-

nized by B under § 1001 upon the sale of the contract to C is long-term capital gain. Rev. Rul. 2009-13. Additionally, the contract was a term contract without any cash value. Hence, the substitute for ordinary income doctrine under *United States v. Midland Ross*, 381 U.S. 54 (1965), and its progeny does not apply.

SITUATION 3

Amount and characterization of income recognized by B upon the receipt of death benefits

As in Situation 1, B must recognize \$71,000 of income upon the receipt of death benefits. This income is “fixed or determinable annual or periodical” income within the meaning of § 881(a)(1). See § 1.1441-2(b); Rev. Rul. 64-51, 1964-1 C.B. 322; Rev. Rul. 2004-75, 2004-2 C.B. 109. Consequently, B is subject to tax under § 881(a) with respect to this income, if the income is from sources within the United States.

Source of income recognized by B upon the receipt of death benefits

Section 861(a)(1) provides that interest received from a domestic corporation is generally from sources within the United States.

Section 861(a)(7) provides that premiums received from the issuance of any life insurance contract are generally income from sources within the United States when the premiums are derived in connection with a life insurance contract issued in respect of the lives of residents of the United States.

Section 865 provides that the source of income from the sale of personal property is generally determined by reference to the residence of the taxpayer.

When the source of an item of income is not specified by statute or by regulation, courts have determined the source of the item by comparison and analogy to classes of income specified within the statute. See *Bank of America v. United States*, 680 F.2d 142, 147 (Ct. Cl. 1982); *Howkins v. Commissioner*, 49 T.C. 689 (1968); *Clayton v. United States*, 33 Fed. Cl. 628 (1995), *aff’d without published opinion*, 91 F.3d 170 (Fed. Cir. 1996), cert. denied, 519

U.S. 1040 (1996). See also Rev. Rul. 79-388, 1979-2 C.B. 270.

The Code does not specify the source of income resulting from the payment of death benefits pursuant to a term life insurance contract. See also Rev. Rul. 2004-75. Consequently, the source of such income is determined by comparison and analogy to classes of income that are specified within the statute.

In the current situation, A is a United States citizen residing in the United States, and IC is a domestic corporation. B’s income is from sources within the United States.

HOLDINGS

1. In Situation 1, B must recognize \$71,000 of ordinary income on the receipt of death benefits with respect to the life insurance contract.

2. In Situation 2, B must recognize \$1,000 of long-term capital gain on the sale of the life insurance contract.

3. In Situation 3, B must recognize \$71,000 of ordinary income from sources within the United States, and tax is imposed under § 881(a)(1) with respect to this amount.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Josephine H. Firehock of the Office of Associate Chief Counsel (International) and Stephen D. Hooe of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this ruling, contact Stephen D. Hooe at (202) 622-7595 (not a toll-free call). For questions relating to section 263(a), contact the Office of Associate Chief Counsel (Income Tax & Accounting) at (202) 622-4800. For questions relating to section 861 or 881, contact Josephine H. Firehock at (202) 622-4233.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

Guidance is provided to investors who purchase life insurance contracts. See Rev. Rul. 2009-14, page 1031.

Section 865.—Source Rules for Personal Property Sales

26 CFR 1.865-1: Loss with respect to personal property other than stock.

Guidance is provided to investors who purchase life insurance contracts. See Rev. Rul. 2009-14, page 1031.

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

26 CFR 1.1001: Computation of gain or loss.

Guidance is provided to policyholders that sell their life insurance contracts. See Rev. Rul. 2009-13, page 1029.

Guidance is provided to investors who purchase life insurance contracts. See Rev. Rul. 2009-14, page 1031.

Section 1011.—Adjusted Basis for Determining Gain or Loss

26 CFR 1.1011-1: Adjusted basis.

Guidance is provided to policyholders that sell their life insurance contracts. See Rev. Rul. 2009-13, page 1029.

Guidance is provided to investors who purchase life insurance contracts. See Rev. Rul. 2009-14, page 1031.

Section 1012.—Basis of Property-Cost

26 CFR 1.1012-1: Basis of property.

Guidance is provided to policyholders that sell their life insurance contracts. See Rev. Rul. 2009-13, page 1029.

Guidance is provided to investors who purchase life insurance contracts. See Rev. Rul. 2009-14, page 1031.

Section 1221.—Capital Asset Defined

26 CFR 1.1221: Meaning of terms.

Guidance is provided to policyholders that sell their life insurance contracts. See Rev. Rul. 2009-13, page 1029.

Guidance is provided to investors who purchase life insurance contracts. See Rev. Rul. 2009-14, page 1031.

Section 1234A.—Gains or Losses From Certain Terminations

Guidance is provided to policyholders that sell their life insurance contracts. See Rev. Rul. 2009-13, page 1029.

Section 1361.—S Corporation Defined

26 CFR 1.1362-6: Elections and consents.
(Also: Sections 7701, 301.7701-1, 301.7701-2, 301.7701-3.)

Formless conversion of partnership to S corporation. This ruling explains that a partnership that converts to a corporation under either regulations section 301.7701-3(c)(1)(i) or under a state law formless conversion statute is allowed to make an S election effective for the corporation's first taxable year.

Rev. Rul. 2009-15

ISSUE

In *Situations 1* and *2* below, when an unincorporated entity taxed as a partnership becomes a corporation for federal tax purposes, is the corporation eligible to elect to be taxed as an S corporation effective its first taxable year?

FACTS

Situation 1

On January 1, 2009, X, a calendar year taxpayer, is organized in *State* as an unincorporated entity that is classified as a partnership for federal tax purposes. X elects under § 301.7701-3(c)(1)(i) of the Procedure and Administrative Regulations to be treated as an association for federal tax purposes, effective January 1, 2010. On February 1, 2010, X files an election under section 1362(a) of the Internal Revenue Code to be taxed as an S corporation, effective January 1, 2010. There is no person who held stock in X on January 1, 2010, who does not hold stock at the time the election is made.

Situation 2

On January 1, 2009, Y, a calendar year taxpayer, is organized in *State* as an unincorporated entity that is classified as a partnership for federal tax purposes. Y converts into a corporation under a state law formless conversion statute, effective January 1, 2010. As a result of the conversion, Y is classified as a corporation for federal tax purposes. On February 1, 2010, Y files an election under section 1362(a) to be taxed as an S corporation, effective January 1, 2010. There is no person who held stock in Y on January 1, 2010, who does not hold stock at the time the election is made.

LAW

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for that year.

Section 1361(b)(1)(B) provides that an S corporation cannot have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) that is not an individual.

Section 1362(a) provides that a small business corporation may elect to be an S corporation.

Section 1362(b)(1) provides that a small business corporation may make an election to be treated as an S corporation for any taxable year (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the third month of the taxable year.

Section 1.1362-6(a)(2)(ii)(B) of the Income Tax Regulations provides that a timely election made by a small business corporation during the taxable year for which it is intended to be effective is nonetheless treated as made for the following taxable year if (1) the corporation is not a small business corporation during the entire portion of the taxable year that occurs before the date the election is made; or (2) any person who held stock in the corporation at any time during the portion of the taxable year that occurs before the time the election is made, and who does not hold stock at the time the election is made, does not consent to the election.

Section 7701(a)(2) provides that the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation.

Section 7701(a)(3) provides that the term "corporation" includes associations, joint-stock companies, and insurance companies.

Section 301.7701-2(b)(1) defines the term "corporation" to include a business entity organized under a federal or state statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic.

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8) (an eligible entity), can elect its classification for federal tax purposes.

Section 301.7701-3(g)(1)(i) provides that, if an eligible entity classified as a partnership elects under § 301.7701-3(c)(1)(i) to be classified as an association, the following is deemed to occur: the partnership contributes all of its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter, the partnership liquidates by distributing the stock of the association to its partners.

Section 301.7701-3(g)(3)(i) provides that an election under § 301.7701-3(c)(1)(i) that changes the classification of an eligible entity for federal tax purposes is treated as occurring at the start of the day for which the election is effective. Any transactions that are deemed to occur under § 301.7701-3(g) as a result of a change in classification are treated as occurring immediately before the close of the day before the election is effective. For example, if an election is made to change the classification of an entity from an association to a partnership effective on January 1, the deemed transactions specified in § 301.7701-3(g)(1)(ii) (including the liquidation of the association) are treated as occurring immediately before the close of December 31 and must be reported by the owners of the entity on December 31. Thus, the last day of the association's

taxable year will be December 31 and the first day of the partnership's taxable year will be January 1.

Rev. Rul. 2004-59, 2004-1 C.B. 1050, explains the federal tax consequences where an unincorporated entity classified as a partnership for federal tax purposes converts into a state law corporation under a state law formless conversion statute. Rev. Rul. 2004-59 concludes that for federal tax purposes, an unincorporated entity classified as a partnership that converts to a corporation under a state law formless conversion statute will be treated in the same manner as one that makes an election to be classified as an association under § 301.7701-3(c)(1)(i).

ANALYSIS

Situation 1

When X, an entity classified as a partnership for federal tax purposes, elects under § 301.7701-3(c)(1)(i) to be classified as an association for federal tax purposes, the following steps are deemed to occur: X contributes all of its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter X liquidates by distributing the stock of the association to its partners. Under § 301.7701-3(g)(3)(i), these deemed steps are treated as occurring immediately before the close of the day before the elec-

tion is effective. Thus, the partnership's taxable year ends on December 31, 2009, and the association's first taxable year begins on January 1, 2010. Therefore, the partnership will not be deemed to own the stock of the association during any portion of the association's first taxable year beginning January 1, 2010, and X is eligible to elect to be an S corporation effective January 1, 2010. Additionally, because the partnership's taxable year ends immediately before the close of the day on December 31, 2009, and the association's first taxable year begins at the start of the day on January 1, 2010, the deemed steps will not cause X to have an intervening short taxable year in which it was a C corporation.

Situation 2

Rev. Rul. 2004-59 provides that the conversion of a partnership into a state law corporation under a state law formless conversion statute is treated in the same manner as if the entity had made an election to be treated as an association under § 301.7701-3(c)(1)(i). Therefore, Y is deemed to contribute all of its assets and liabilities to the corporation in exchange for stock in the corporation, and immediately thereafter Y liquidates by distributing the stock of the corporation to its partners. As in *Situation 1*, the partnership will not be deemed to own the stock of the cor-

poration during any portion of the corporation's first taxable year beginning January 1, 2010, and Y is eligible to elect to be an S corporation effective January 1, 2010. Additionally, because the partnership's taxable year ends immediately before the close of the day on December 31, 2009, and the corporation's first taxable year begins at the start of the day on January 1, 2010, the deemed steps will not cause Y to have an intervening short taxable year in which it was a C corporation.

HOLDINGS

In *Situations 1* and 2, when an unincorporated entity taxed as a partnership becomes a corporation for federal tax purposes, the corporation is eligible to elect to be taxed as an S corporation effective its first taxable year. Additionally, the corporation will not be deemed to have an intervening short taxable year in which it was a C corporation.

DRAFTING INFORMATION

The principal author of this revenue ruling is Steven A. Schmoll of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue ruling, contact Steven A. Schmoll at (202) 622-3050 (not a toll-free call).

Part III. Administrative, Procedural, and Miscellaneous

Public Comment Invited on Recommendations for 2009–2010 Guidance Priority List

Notice 2009–43

The Department of Treasury and Internal Revenue Service invite public comment on recommendations for items that should be included on the 2009–2010 Guidance Priority List.

The Treasury Department's Office of Tax Policy and the Service use the Guidance Priority List each year to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance. The 2009–2010 Guidance Priority List will establish the guidance that the Treasury Department and the Service intend to issue from July 1, 2009, through June 30, 2010. The Treasury Department and the Service recognize the importance of public input to formulate a Guidance Priority List that focuses resources on guidance items that are most important to taxpayers and tax administration. Published guidance plays an important role in increasing voluntary compliance by helping to clarify ambiguous areas of the tax law.

As is the case whenever significant legislation is enacted, the Treasury Department and the Service have continued to dedicate substantial resources during the current plan year to published guidance projects necessary to implement the provisions of the multitude of tax Acts that have been enacted over the past several years including, but not limited to, the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418, which was enacted on October 22, 2004; the Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780, which was enacted on August 17, 2006; the Economic Stimulus Act of 2008, Pub. L. No. 110–185, 122 Stat. 613, which was enacted on February 13, 2008; the Housing Assistance Tax Act of 2008, Pub. L. No. 110–289, 122 Stat. 2654, which was enacted on July 30, 2008; the Emergency Economic Stabilization Act of 2008, Energy Improvement and

Extension Act of 2008, and Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Pub. L. No. 110–343, 122 Stat. 3765, which were enacted on October 3, 2008; and the American Recovery and Reinvestment Tax Act of 2009, Pub. L. No. 111–5, 123 Stat. 115, which was enacted on February 17, 2009. The Treasury Department and the Service will continue to evaluate the priority of each guidance project in light of the above-mentioned tax legislation and other developments occurring during the 2009–2010 plan year.

In reviewing recommendations and selecting projects for inclusion on the 2009–2010 Guidance Priority List, the Treasury Department and the Service will consider the following:

1. Whether the recommended guidance resolves significant issues relevant to many taxpayers;
2. Whether the recommended guidance promotes sound tax administration;
3. Whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance;
4. Whether the Service can administer the recommended guidance on a uniform basis; and
5. Whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

Taxpayers may submit recommendations for guidance at any time during the year. Please submit recommendations by May 31, 2009, for possible inclusion on the original 2009–2010 Guidance Priority List. The Treasury Department and the Service may update the 2009–2010 Guidance Priority List periodically to reflect additional guidance that the Treasury Department and the Service intend to publish during the plan year. The periodic updates allow the Treasury Department and the Service to respond to the need for additional guidance that may arise during the plan year. Recommendations for guidance received after May 31, 2009, will be reviewed for inclusion in the next periodic update.

Taxpayers are not required to submit recommendations for guidance in any particular format. Taxpayers should, how-

ever, briefly describe the recommended guidance and explain the need for the guidance. In addition, taxpayers may include an analysis of how the issue should be resolved. It would be helpful if taxpayers suggesting more than one guidance project prioritize the projects by order of importance. If a large number of projects are being suggested, it also would be helpful if the projects were grouped in terms of high, medium or low priority.

Taxpayers should send written comments to:

Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2009–43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand deliver comments Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2009–43)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Alternatively, taxpayers may submit comments electronically via e-mail to the following address: *Notice.Comments@irs.counsel.treas.gov*. Taxpayers should include "Notice 2009–43" in the subject line. All comments submitted by the public will be available for public inspection and copying in their entirety.

For further information regarding this notice, contact Henry Schneiderman of the Office of Associate Chief Counsel (Procedure and Administration) at (202) 622–3400 (not a toll-free call).

Low-Income Housing Credit

Notice 2009–44

PURPOSE

The purpose of this notice is to clarify that, under § 1.42–10 of the Income Tax

Regulations (the utility allowance regulations), utility costs paid by a tenant based on actual consumption in a sub-metered rent-restricted unit as described herein are treated as paid directly by the tenant for purposes of § 42(g)(2)(B)(ii) of the Internal Revenue Code.

BACKGROUND

Section 42 sets forth rules for determining the amount of the low-income housing credit, which is allowed as a credit against income tax pursuant to § 38. Section 42(a) provides that the amount of the low-income housing credit determined under § 42 for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building. A qualified low-income building is defined in § 42(c)(2) as any building that is part of a qualified low-income housing project.

A qualified low-income housing project is defined in § 42(g)(1) as any project for residential rental property if the project meets one of the following tests elected by the taxpayer: (A) At least 20 percent of the residential units in the project are rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income; or (B) at least 40 percent of the residential units in the project are rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income. Failure to qualify as a rent-restricted unit may result in ineligibility for the section 42 credit, reduction in the amount of the credit, and/or recapture of previously allowed credits. In order to qualify as a rent-restricted unit within the meaning of § 42(g)(2), the gross rent for the unit must not exceed 30 percent of the applicable income limitation. Section 42(g)(2)(B)(ii) provides that gross rent includes a utility allowance determined by the Secretary after taking into account the procedures under section 8 of the United States Housing Act of 1937.

Section 1.42-10, which was recently amended by Treasury decision 9420 on July 29, 2008 (73 FR 43863), sets forth the circumstances under which gross rent includes a utility allowance and provides rules for determining the applicable utility allowance. Under § 1.42-10(a), if the cost of any utility (other than telephone, cable television, or Internet) for a residen-

tial rental unit is paid directly by the tenant(s), and not by or through the owner of the building, the gross rent for that unit includes a utility allowance.

If gross rent includes a utility allowance, § 1.42-10(b) provides rules for determining the applicable utility allowance depending upon whether (1) the building receives rental assistance from the Rural Housing Service (RHS) (“RHS-assisted building”), (2) the building has any tenant that receives RHS rental assistance payments (“RHS tenant assistance”), (3) the rents and utility allowances of the building are reviewed by the Department of Housing and Urban Development (HUD) (“HUD-regulated building”), or (4) the building is not described in (1), (2), or (3) (“other building”). Section 1.42-10(b)(1) and (2) provides that, for an RHS-assisted building and a building with RHS tenant assistance, the applicable utility allowance is the applicable RHS utility allowance. Section 1.42-10(b)(3) provides that, for a HUD-regulated building, the applicable utility allowance is the applicable HUD utility allowance. With respect to other buildings, § 1.42-10(b)(4)(i) provides that, for all rent-restricted units occupied by tenants receiving HUD tenant assistance, the applicable utility allowance is the applicable Public Housing Authority (PHA) utility allowance established for the Section 8 Existing Housing Program. With respect to all other tenants in other buildings, § 1.42-10(b)(4)(ii) provides that the applicable utility allowance is the applicable PHA utility allowance under § 1.42-10(b)(4)(ii)(A), a local utility company estimate under § 1.42-10(b)(4)(ii)(B), an estimate from the State or local housing credit agency that has jurisdiction over the building under § 1.42-10(b)(4)(ii)(C), the HUD Utility Schedule Model under § 1.42-10(b)(4)(ii)(D), or an energy consumption model under § 1.42-10(b)(4)(ii)(E).

Some buildings in qualified low-income housing projects are sub-metered. Sub-metering measures tenants’ actual utility consumption, and tenants pay for the utilities they use. A sub-metering system typically includes a master meter, which is owned or controlled by the utility supplying the electricity, gas, or water, with overall utility consumption billed to the building owner. In a sub-metered

system, building owners (or their agents) use unit-based meters to measure utility consumption and prepare a bill for each residential unit based on consumption. The building owners (or their agents) retain records of resident utility consumption, and tenants receive documentation of utility costs as specified in the lease.

DISCUSSION

For purposes of § 1.42-10(a) of the utility allowance regulations, utility costs paid by a tenant based on actual consumption in a sub-metered rent-restricted unit are treated as paid directly by the tenant, and not by or through the owner of the building. For RHS-assisted buildings under § 1.42-10(b)(1), buildings with RHS tenant assistance under § 1.42-10(b)(2), HUD-regulated buildings under § 1.42-10(b)(3), and rent-restricted units in other buildings occupied by tenants receiving HUD rental assistance under § 1.42-10(b)(4)(i), the applicable RHS or HUD rules apply. For all other tenants in rent-restricted units in other buildings under § 1.42-10(b)(4)(ii):

(1) The utility rates charged to tenants in each sub-metered rent-restricted unit must be limited to the utility company rates incurred by the building owners (or their agents);

(2) If building owners (or their agents) charge tenants a reasonable fee for the administrative costs of sub-metering, then the fee will not be considered gross rent under § 42(g)(2). The fee must not exceed an aggregate amount per unit of 5 dollars per month unless State law provides otherwise; and

(3) If the costs for sewerage are based on the tenants’ actual water consumption determined with a sub-metering system and the sewerage costs are on a combined water and sewerage bill, then the tenants’ sewerage costs are treated as paid directly by the tenants for purposes of the utility allowances regulations.

The utility allowance regulations will be amended to incorporate the guidance set forth in this notice.

EFFECTIVE DATE

This notice is effective for utility allowances subject to the effective date in § 1.42-12(a)(4). Consistent with § 1.42-12(a)(4), building owners (or their

agents) may rely on this notice for any utility allowances effective no earlier than the first day of the building owner's taxable year beginning on or after July 29, 2008.

REQUEST FOR COMMENTS

The Treasury Department and IRS invite taxpayers to submit written comments on issues relating to this notice. Send comments to: CC:PA:LPD:PR (Notice 2009-44), Room 5205, Inter-

nal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2009-44), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Submissions may also be sent electronically via the Internet to the following e-mail address: Notice.comments@irs.counsel.treas.gov. Include the notice number (Notice

2009-44) in the subject line. Comments must be received on or before July 27, 2009. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is David Selig, Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, please contact Mr. Selig at (202) 622-3040 (not a toll-free call).

Part IV. Items of General Interest

Gain Recognition Agreements With Respect to Certain Transfers of Stock or Securities by United States Persons to Foreign Corporations; Correction

Announcement 2009-45

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendments.

SUMMARY: This document contains corrections to final regulations (T.D. 9446, 2009-9 I.R.B. 607) that were published in the **Federal Register** on Wednesday, February 11, 2009 (74 FR 6952) concerning gain recognition agreements filed by United States persons with respect to transfers of stock or securities to foreign corporations.

DATES: This correction is effective on May 26, 2009, and is applicable on March 13, 2009.

FOR FURTHER INFORMATION CONTACT: S. James Hawes, (202) 622-3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of this document are under section 367(a) of the Internal Revenue Code.

Need for Correction

The final regulations (T.D. 9446) that were published in the **Federal Register** on February 11, 2009, inadvertently removed Treas. Reg. §1.367(a)-3T in its entirety rather than removing §1.367(a)-3T(e), (f)(1), (f)(2), and the second sentence of §1.367(a)-3T(f)(3). This document correctly adds the text of §1.367(a)-3T back into the Code of Federal Regulations.

* * * * *

Accordingly, 26 CFR Part 1 is corrected by making the following correcting amendments:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.367(a)-3T is added to read as follows:

§1.367(a)-3T Treatment of transfers of stock or securities to foreign corporations (temporary).

(a) through (b)(2)(i)(B) [Reserved]. For further guidance, see §1.367(a)-3(a) through (b)(2)(i)(B).

(b)(2)(i)(C) If in connection with a transaction described in §1.367(b)-14T, one or more U.S. persons transfer stock of T, as defined in §1.358-6(b)(1)(iii), to a corporation in a transfer described in section 367(a), and the amount of gain in the T stock that would otherwise be recognized under section 367(a) is less

than the deemed distribution that would result from the adjustments made under §1.367(b)-14T and that would be treated as a dividend under section 301(c)(1), then section 367(b), and not section 367(a), shall apply to such transaction. This paragraph (b)(2)(i)(C) applies to transfers occurring on or after May 23, 2008.

(b)(2)(ii) through (f) [Reserved]. For further guidance, see §1.367(a)-3(b)(2)(ii) through (f).

(g) *Effective/applicability date.* Paragraph (b)(2)(i)(C) of this section applies to transfers occurring on or after May 23, 2008.

(h) *Expiration date.* The applicability of paragraph (b)(2)(i)(C) of this section expires on May 23, 2011.

§1.367(a)-8(r)(2) [Corrected]

Par. 3. Section 1.367(a)-8(r)(2) is amended by revising the paragraph heading to read as follows:

(2) *Applicability to transfers occurring before March 13, 2009—(i)* * * *

* * * * *

Robin Jones,
*Federal Register Liaison,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).*

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Announcement of Disciplinary Sanctions From the Office of Professional Responsibility

Announcement 2009-46

The Office of Professional Responsibility (OPR) announces recent disciplinary sanctions involving attorneys, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and appraisers. These individuals are subject to the regulations governing practice before the Internal Revenue Service (IRS), which are set out in Title 31, Code of Federal Regulations, Part 10, and

which are published in pamphlet form as Treasury Department Circular No. 230. The regulations prescribe the duties and restrictions relating to such practice and prescribe the disciplinary sanctions for violating the regulations.

The disciplinary sanctions to be imposed for violation of the regulations are:

Disbarred from practice before the IRS—An individual who is disbarred is

not eligible to represent taxpayers before the IRS.

Suspended from practice before the IRS—An individual who is suspended is not eligible to represent taxpayers before the IRS during the term of the suspension.

Censured in practice before the IRS—Censure is a public reprimand. Unlike disbarment or suspension, censure does not affect an individual's eligibility

to represent taxpayers before the IRS, but OPR may subject the individual's future representations to conditions designed to promote high standards of conduct.

Monetary penalty—A monetary penalty may be imposed on an individual who engages in conduct subject to sanction or on an employer, firm, or entity if the individual was acting on its behalf and if it knew, or reasonably should have known, of the individual's conduct.

Disqualification of appraiser—An appraiser who is disqualified is barred from presenting evidence or testimony in any administrative proceeding before the Department of the Treasury or the IRS.

Under the regulations, attorneys, certified public accountants, enrolled agents, enrolled actuaries, and enrolled retirement plan agents may not assist, or accept assistance from, individuals who are suspended or disbarred with respect to matters constituting practice (*i.e.*, representation) before the IRS, and they may not aid or abet suspended or disbarred individuals to practice before the IRS.

Disciplinary sanctions are described in these terms:

Disbarred by decision after hearing, Suspended by decision after hearing, Censured by decision after hearing, Monetary penalty imposed after hearing, and Disqualified after hearing—An administrative law judge (ALJ) conducted an evidentiary hearing upon OPR's complaint alleging violation of the regulations and issued a decision imposing one of these sanctions. After 30 days from the issuance of the decision, in the absence of

an appeal, the ALJ's decision became the final agency decision.

Disbarred by default decision, Suspended by default decision, Censured by default decision, Monetary penalty imposed by default decision, and Disqualified by default decision—An ALJ, after finding that no answer to OPR's complaint had been filed, granted OPR's motion for a default judgment and issued a decision imposing one of these sanctions.

Disbarment by decision on appeal, Suspended by decision on appeal, Censured by decision on appeal, Monetary penalty imposed by decision on appeal, and Disqualified by decision on appeal—The decision of the ALJ was appealed to the agency appeal authority, acting as the delegate of the Secretary of the Treasury, and the appeal authority issued a decision imposing one of these sanctions.

Disbarred by consent, Suspended by consent, Censured by consent, Monetary penalty imposed by consent, and Disqualified by consent—In lieu of a disciplinary proceeding being instituted or continued, an individual offered a consent to one of these sanctions and OPR accepted the offer. Typically, an offer of consent will provide for: suspension for an indefinite term; conditions that the individual must observe during the suspension; and the individual's opportunity, after a stated number of months, to file with OPR a petition for reinstatement affirming compliance with the terms of the consent and affirming current eligibility to practice (*i.e.*, an active professional

license or active enrollment status). An enrolled agent or an enrolled retirement plan agent may also offer to resign in order to avoid a disciplinary proceeding.

Suspended by decision in expedited proceeding, Suspended by default decision in expedited proceeding, Suspended by consent in expedited proceeding—OPR instituted an expedited proceeding for suspension (based on certain limited grounds, including loss of a professional license and criminal convictions).

OPR has authority to disclose the grounds for disciplinary sanctions in these situations: (1) an ALJ or the Secretary's delegate on appeal has issued a decision on or after September 26, 2007, which was the effective date of amendments to the regulations that permit making such decisions publicly available; (2) the individual has settled a disciplinary case by signing OPR's "consent to sanction" form, which requires consenting individuals to admit to one or more violations of the regulations and to consent to the disclosure of the individual's own return information related to the admitted violations (for example, failure to file Federal income tax returns); or (3) OPR has issued a decision in an expedited proceeding for suspension.

Announcements of disciplinary sanctions appear in the Internal Revenue Bulletin at the earliest practicable date. The sanctions announced below are alphabetized first by the names of states and second by the last names of individuals. Unless otherwise indicated, section numbers (*e.g.*, §10.51) refer to the regulations.

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
Alabama				
Andalusia	White, Gregory B.	CPA	Suspended by consent for violation of § 10.51 (failure to timely file several Federal tax returns)	Indefinite from April 20, 2009

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
Arizona				
Phoenix	Everett, James J.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (conviction under 18 U.S.C. § 152, false declaration in bankruptcy proceedings; 18 U.S.C. § 157 bankruptcy fraud; and 18 U.S.C. §1956, money laundering/concealment)	Indefinite from May 7, 2009
Tucson	Lacsamana, Vincent	Attorney	Suspended by consent for violation of § 10.51 (failure to file several Federal tax returns)	Indefinite from March 26, 2009
Arkansas				
Camden	Lindsey, Jr., Lloyd E.	CPA	Suspended by consent for violation of § 10.51 (failure to timely file several Federal tax returns)	Indefinite from April 16, 2009
California				
Laguna Hills	Llorente, Alex J.	Attorney	Disbarred by decision on appeal for violation of § 10.51 (willful failure to file a Federal tax return)	Indefinite from April 10, 2009
Colorado				
Fort Collins	Sweetman, Debra A.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from April 17, 2009
Georgia				
Lagrange	Rainey, Esther S.	CPA	Suspended by consent for violation of § 10.51 (failure to timely file several Federal tax returns)	Indefinite from April 16, 2009
Illinois				
Chicago	Kearns, John W.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from April 17, 2009

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
New York				
Orangeburg	Rogers, Barnett R.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (suspension of attorney license)	Indefinite from April 15, 2009
Pennsylvania				
Boyertown	Fryer, Charles E.	Attorney	Suspended by consent for violation of § 10.51 (failure to timely file several Federal tax returns)	Indefinite from April 6, 2009
Tennessee				
Crossville	Mercer, Howard L.	CPA	Suspended by consent for violation of § 10.51 (failure to timely file several Federal tax returns)	Indefinite from April 20, 2009
Texas				
Houston	Elsom, William D.	CPA	Suspended by decision in expedited proceeding under § 10.82 (suspension CPA license in Wyoming)	Indefinite from May 6, 2009
Odessa	Hargus, Richard	Enrolled Agent	Suspended by consent for violation of § 10.22 (failed to exercise due diligence while employed with two companies that specialize in tax resolution services through the Offer in Compromise (OIC) program; specifically that practitioner did not perform services related to OIC's paid for by taxpayers)	Indefinite from April 6, 2009
Wyoming				
	Elsom, William D. See Texas			

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance

of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.

ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.

PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
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26 CFR 20.2031-0, revised; 20.2031-7, amended; 20.2031-7A, amended; 20.2031-7T, added; 20.2032-1, amended; 20.2032-1T, added; 20.2055-2, amended; 20.2055-2T, added; 20.2056A-4, amended; 20.2056A-4T, added; 20.7520-1, amended; 20.7520-1T, added; use of actuarial tables in valuing annuities, interests for life or terms of years and remainder or reversionary interests (TD 9448) 20, 942

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26 CFR 41.4481-1, -2, amended; 41.4483-3, amended; 41.4483-7, removed; 41.6001-1, -2, amended; 41.6011(a)-1, amended; 41.6071(a)-1, amended; 41.6156-1, removed; highway use tax; sold vehicles and electronic filing (REG-116699-07) 13, 727

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26 CFR 25.2512-5, amended; 25.2522(c)-3, amended; 25.7520-1, -3, amended; 25.2512-5A, amended; 25.2512-5T, added; 25.2522(c)-3, amended; 25.2522(c)-3T, added; 25.7520-1, amended; 25.7520-1T, added; 25.7520-3, amended; 25.7520-3T, added; use of actuarial tables in valuing annuities, interests for life or terms of years and remainder or reversionary interests (REG-107845-08) 20, 1014

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26 CFR 25.2512-0, revised; 25.2512-5, amended; use of actuarial tables in valuing annuities, interests for life or terms of years and remainder or reversionary interests (TD 9448) 20, 942

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26 CFR 1.170A-12, amended; 1.642(c)-6, amended; 1.664-4, amended; 1.7520-1, amended; use of actuarial tables in valuing annuities, interests for life or terms of years and remainder or reversionary interests (REG-107845-08) 20, 1014

26 CFR 1.301-2, added; 1.302-2(c), removed; 1.302-5, added; 1.304-1, revised; 1.304-2, -3, -5, amended; 1.351-2, amended; 1.354-1, amended; 1.355-1, amended; 1.356-1, amended; 1.358-1, -2, revised; 1.358-6, amended; 1.368-1, amended; 1.861-12, added; 1.1002-1, redesignated as 1.1001-6, and amended; 1.1016-2, amended; 1.1374-10, revised; the allocation of consideration and allocation and recovery of basis in transactions involving corporate stock or securities (REG-143686-07) 8, 579; correction (Ann 40) 20, 1023

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26 CFR 1.338-1, amended; 1.367(a)-3, amended; 1.367(a)-3T, -8T, removed; 1.367(a)-8, revised; 602.101, amended; transfers by U.S. persons of stock or securities to foreign corporations (TD 9446) 9, 607; correction (Ann 23) 13, 731; additional corrections (Ann 45) 21, 1040

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