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

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

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

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

REQUEST FOR COMMENTS

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

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

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

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

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

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

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

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

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

DRAFTING INFORMATION

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

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

Notice 97–64

SECTION 1. PURPOSE

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

SEC. 2. BACKGROUND

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

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

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

SEC. 3. BASIC DESIGNATION RULE

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

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

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

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

SEC. 4. SHAREHOLDER TREATMENT OF CAPITAL GAIN DIVIDENDS

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

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

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

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

SEC. 5. LIMITATIONS ON DESIGNATIONS OF CAPITAL GAIN DIVIDENDS

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

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

SEC. 6. DEFERRAL ADJUSTMENT AND BIFURCATION ADJUSTMENT

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

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

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

SEC. 7. EXAMPLES

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

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

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

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

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

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

SEC. 8. SECTION 1202 GAIN

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

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

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

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

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

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

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

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

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

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

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

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

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

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

SEC. 11. SUBMISSION OF COMMENTS

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

SEC. 12 PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1565.

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

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

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

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

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

The estimated annual frequency of responses is annually.

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

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

DRAFTING INFORMATION

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

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

Rev. Proc. 97–53

SECTION 1. PURPOSE

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

SECTION 2. BACKGROUND

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

SECTION 3. PROCEDURE

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

SECTION 4. EFFECTIVE DATE

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

DRAFTING INFORMATION

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