Part III. Administrative, Procedural, and Miscellaneous

Guidance Regarding Qualified Intellectual Property Contributions

Notice 2005–41

PURPOSE

This notice provides guidance regarding § 882 of the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418 (2004), which adds §§ 170(e)(1)(B)(iii) and 170(m) to the Internal Revenue Code and amends § 6050L. Section 170(e)(1)(B)(iii) provides that the amount of a donor's initial charitable contribution deduction allowed under § 170 for contributions of qualified intellectual property is limited to the lesser of the fair market value of, or the donor's adjusted basis in, the qualified intellectual property. Section 170(m) allows the donor to deduct, as a charitable contribution, certain additional amounts based on a percentage of the qualified donee income received by or accrued to the donee with respect to the qualified intellectual property. To qualify for the additional deductions, the donor must notify the donee at the time of the contribution of the donor's intention to take the additional deductions. As amended, § 6050L(b) requires a donee to make a return in the form and manner prescribed by the Secretary with respect to each qualified intellectual property contribution. Sections 170(e)(1)(B)(iii) and 170(m), and the amendments to § 6050L, are effective for contributions made after June 3, 2004.

BACKGROUND

Section 170(a) allows a deduction for a charitable contribution. Generally, if a donor makes a charitable contribution of property, the amount of the deduction is the fair market value of the property at the time of the contribution, reduced as provided in § 170(e) and § 1.170A–4 of the Income Tax Regulations. For certain types of property, § 170(e)(1)(B) reduces the amount of the deduction by the amount of gain that would have been long-term capital gain if the donor had sold the property at its fair market value, determined as of the time of the contribution. Under § 170(e)(1)(B)(iii), this reduction applies in determining a donor's initial deduction for a charitable contribution of "any patent, copyright (other than a copyright described in section 1221(a)(3) or 1231(b)(1)(C)), trademark, trade name, trade secret, know-how, software (other than software described in section 197(e)(3)(A)(i)), or similar property, or applications or registrations of such property."

Subject to the terms and limitations of § 170, § 170(m) allows a donor of qualified intellectual property to deduct, in the year of contribution or in subsequent taxable years, additional amounts based on a percentage (specified in § 170(m)(7)) of the qualified donee income received by or accrued to the donee with respect to the qualified intellectual property. For this purpose, "qualified intellectual property" is property described in § 170(e)(1)(B)(iii) other than property contributed to or for the use of private foundations as defined in § 509(a) (with certain exceptions as described in § 170(b)(1)(E)). "Qualified donee income" is any net income properly allocable to the qualified intellectual property (as opposed to the activity in which the intellectual property is used) that is received by or accrued to the donee organization during the year. Qualified donee income does not include any income received by or accrued to the donee organization after the earlier of the tenth anniversary of the date of the contribution or the expiration of the legal life of the qualified intellectual property. *See* § 170(m)(5) and (6). Additional deductions are allowed, however, only to the extent that the aggregate of the specified percentages of qualified donee income exceeds the initial deduction claimed by the donor. *See* § 170(m)(2).

To qualify for the additional deductions, the donor must inform the donee at the time of the contribution that the donor intends to treat the contribution as a qualified intellectual property contribution (the notification requirement). *See* § 170(m)(8).

Section 6050L(b), as amended by the Act, requires a donee (which may not be a private foundation described in section 170(e)(1)(B)(ii)) that receives notification from the donor to make a return with respect to a qualified intellectual property contribution for each taxable year of the donee showing the amount of any qualified donee income. Section 6050L(c) requires the donee to provide a copy of the return to the donor. *See also* § 1.6050L–2T of the Procedure and Administration Regulations (May 23, 2005); Prop. Treas. Reg. § 1.6050L–2 (May 23, 2005). The amount of net income taken into account by the donor may not exceed the amount of qualified donee income reported by the donee under § 6050L.

GUIDANCE ON THE NOTIFICATION REQUIREMENT

General rule

A donor will satisfy the notification requirement under § 170(m)(8) if the donor delivers or mails to the donee, at the time of the contribution, a written statement containing the following information:

1. The name, address, and taxpayer identification number of the donor;
2. A description of the qualified intellectual property in sufficient detail to identify the qualified intellectual property received by the donee;
3. The date of the contribution to the donee; and
4. A statement that the donor intends to treat the contribution as a qualified intellectual property contribution for purposes of §§ 170(m) and 6050L.

Transitional rule for contributions made after June 3, 2004, and on or before June 20, 2005

Section 170(m) was enacted on October 22, 2004, and is effective for contributions made after June 3, 2004. Donors may have made contributions of qualified intellectual property after June 3, 2004, and may not have informed the donee at the time of the contribution that they intended to treat the contribution as a qualified intellectual property contribution

A donor who contributed qualified intellectual property after June 3, 2004, and on or before June 20, 2005, without notifying the donee that it intended to treat the contribution as a qualified intellectual property contribution will be regarded as satisfying the notification requirement if, on or before July 20, 2005, the donor delivers or mails to the donee a written statement containing the information described above.

PAPERWORK REDUCTION ACT

The collection of information in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1937.

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 collection of information in this notice is in the GUIDANCE ON THE NOTIFICATION REQUIREMENT section of this notice. The collection of information is required from donors to satisfy the notification requirement of § 170(m). The collection of information is required from donors to obtain a benefit. The likely respondents are individuals, partnerships, and corporations.

The estimated total annual reporting burden is 30 hours.

The estimated annual burden per respondent varies from 0.5 hours to 1.5 hours, depending on individual circumstances, with an estimated average of 1 hour. The estimated number of respondents is 30.

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 return information are confidential, as required by § 6103.

DRAFTING INFORMATION

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Modification of Application of Rule Prohibiting Deferred Compensation Under a Cafeteria Plan

Notice 2005–42

PURPOSE

The purpose of this notice is to modify the application of the rule prohibiting deferred compensation under a § 125 cafeteria plan. This notice permits a grace period immediately following the end of each plan year during which unused benefits or contributions remaining at the end of the plan year may be paid or reimbursed to plan participants for qualified benefit expenses incurred during the grace period.

BACKGROUND

In general, no amount is included in the gross income of a participant in a cafeteria plan solely because, under the plan, the participant may choose among the benefits of the plan. Section 125(a). A cafeteria plan is defined in § 125(d)(1) as a written plan maintained by an employer under which all participants are employees, and the participants may choose among two or more benefits consisting of cash and qualified benefits. Section 125(f) defines a "qualified benefit" as any benefit which, with the application of § 125(a), is not includable in the gross income of the employee by reason of an express provision of Chapter I of the Internal Revenue Code (other than §§ 106(b), 117, 127 or 132). Qualified benefits include employer-provided accident and health plans excludable from gross income under §§ 106 and 105(b), group-term life insurance excludable under § 79, dependent care assistance programs excludable under § 129 and adoption assistance programs excludable under § 137. Elections under a cafeteria plan, once made, can be changed or revoked only as provided in Treas. Reg. § 1.125–4. A cafeteria plan must have a plan year specified in the written plan document. Prop. Treas. Reg. § 1.125–1, Q&A–3.

Section 125(d)(2)(A) states that the term "cafeteria plan" does not include any plan which provides for deferred compensation. The statutory prohibition on deferred compensation in a cafeteria plan is addressed in Prop. Treas. Reg. §§ 1.125–1 and 1.125–2. Prop. Treas. Reg. § 1.125–2, Q&A–5 states that:

> A cafeteria plan may not include any plan that offers a benefit that defers the receipt of compensation. In addition, a cafeteria plan may not operate in a manner that enables employees to defer compensation. For example, a plan that permits employees to carry over unused elective contributions or plan benefits (*e.g.*, accident or health plan coverage) from one plan year to another operates to defer compensation. This is the case regardless of how the contributions or benefits are used by the employee in the subsequent plan year (*e.g.*, whether they are automatically or electively converted into another taxable or nontaxable benefit in the subsequent plan year or used to provide additional benefits of the same type). Similarly, a cafeteria plan operates to permit the deferral of compensation if the plan permits participants to use contributions for one plan year to purchase a benefit that will be provided in a subsequent plan year … .

See also Prop. Treas. Reg. § 1.125–1, Q&A–7.

Thus, a cafeteria plan does not include any plan that defers the receipt of compensation or operates in a manner that enables participants to defer compensation by, for example, permitting participants to use contributions for one plan year to purchase a benefit that will be provided in a subsequent plan year. This rule is commonly referred to as the "use-it-or-lose-it" rule, requiring that unused contributions or benefits remaining at the end of the plan year be "forfeited."

However, other areas of tax law provide that for a short, limited period, compensation for services paid in the year following the year in which the services that are being compensated were performed is not treated as "deferred compensation." For example, Treas. Reg. § 1.404(b)–1T, Q&A–2(a) provides that for purposes of the deduction rules in § 404(a), (b) and (d), a plan, or method or arrangement defers the receipt of compensation or benefits to the extent it is one under which an employee receives compensation or benefits more than a brief period of time after the end of the employer's taxable year in which the services cre-