care that is provided to individuals eligible for assistance under the organization's financial assistance policy to not more than the amounts generally billed to individuals who have insurance covering such care. Section 501(r)(5) also prohibits the use of gross charges.

The Technical Explanation states that "[i]t is intended that amounts billed to those who qualify for financial assistance may be based on either the best, or an average of the three best, negotiated commercial rates, or Medicare rates." Technical Explanation at 82.

Section 5. BILLING AND COLLECTION

Section 501(r)(6) requires a hospital organization to forego extraordinary collection actions against an individual before the organization has made reasonable efforts to determine whether the individual is eligible for assistance under the hospital organization's financial assistance policy.

The Technical Explanation states that "extraordinary collections include lawsuits, liens on residences, arrests, body attachments, or other similar collection processes." Technical Explanation at 82. The Technical Explanation also states that "[i]t is intended that for this purpose, 'reasonable efforts' includes notification by the hospital of its financial assistance policy upon admission and in written and oral communications with the patient regarding the patient's bill, including invoices and telephone calls, before collection action or reporting to credit agencies is initiated." Technical Explanation at 82.

Section 6. EFFECTIVE DATES

Section 501(r) (except for section 501(r)(3)), section 6033(b)(10), and section 6033(b)(15) apply to taxable years beginning after March 23, 2010, the date of enactment of the Affordable Care Act. The CHNA requirements of section 501(r)(3) are effective for taxable years beginning after March 23, 2012. The section 4959 excise tax for failure to satisfy section 501(r)(3) is effective for failures occurring after the date of enactment.

Section 7. REQUEST FOR COMMENTS

The IRS and the Department of Treasury request comments regarding the requirements for hospital organizations described in this notice, including in particular the need, if any, for guidance regarding such requirements. Comments are specifically requested regarding appropriate requirements for a CHNA, and what constitutes "reasonable efforts" to determine eligibility for assistance under a financial assistance policy for purposes of the billing and collection requirements under section 501(r)(6). In addition, comments are requested regarding section 501(r)(2)(B)(ii), which provides that an organization that operates more than one hospital facility "shall not be treated as described in [section 501(c)(3)] with respect to any such facility for which such requirements are not separately met," including the tax consequences of a failure with respect to some, but not all, facilities and the proper tax treatment in future periods in such a case.

Comments should refer to Notice 2010–39 and be submitted by July 22, 2010, to:

Internal Revenue Service
CC:PA:LPD:PR (Notice 2010–39)
Room 5203
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:

Courier's Desk
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, DC 20224
Attn: CC:PA:LPD:PR
(Notice 2010–39)

Alternatively, taxpayers may submit comments electronically to *notice.comments@irscounsel.treas.gov*. Please include "Notice 2010–39" in the subject line of any electronic communications.

All comments will be available for public inspection and copying.

Section 8. DRAFTING INFORMATION

The principal author of this notice is Garrett Gluth of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this notice, contact Mr. Gluth at (202) 283–9485 (not a toll-free call).

Prevention of Over-Withholding and U.S. Tax Avoidance With Respect to Certain Substitute Dividend Payments

Notice 2010–46

I. SUMMARY AND MODIFICATION AND WITHDRAWAL OF NOTICE 97–66

A. Background

On October 14, 1997, final regulations were published in the Federal Register (T.D. 8735, 1997–2 C.B. 72, 62 FR 53498 (1997)) (the "final regulations") that source substitute interest and substitute dividend payments made pursuant to a securities lending transaction described in § 1058 of the Internal Revenue Code ("Code") or a substantially similar transaction or a sale-repurchase transaction (a "Securities Lending Transaction") by reference to the income that would be earned with respect to the underlying transferred debt security or stock. The final regulations also provide that substitute interest and dividend payments that are from sources within the United States under the regulations are characterized as interest and dividends for purposes of determining the fixed or determinable annual or periodical income of nonresident alien individuals and foreign corporations subject to tax under §§ 871(a), 881, 4948(a) and Chapter 3 of the Code and for purposes of granting tax treaty benefits with respect to interest and dividends. As promulgated, the final regulations were made applicable in all respects for substitute interest payments (as defined in § 1.861–2(a)(7)) and substitute dividend payments (as defined in § 1.861–3(a)(6)) made after November 13, 1997.

Some taxpayers expressed concern that the total U.S. gross-basis tax paid with respect to a series of Securities Lending Transactions (that is, a chain of related Securities Lending Transactions with respect to identical securities) could be excessive under the final regulations. For example, a

series of Securities Lending Transactions could give rise to multiple substitute payments, each of which would be treated as equivalent to a dividend under the final regulations. If a dividend distribution on the transferred security were U.S.-source income, each substitute dividend payment in the series would be treated as U.S.-source income and potentially subject to gross-basis taxation under §§ 871 and 881 and withholding of tax under §§ 1441 and 1442. Thus, a series of Securities Lending Transactions could result in "cascading" taxation that might, in the aggregate, exceed 30 percent of the amount of the dividend distribution on the underlying transferred security.

To allow relief for taxpayers unable to structure transactions to avoid excessive or cascading taxation, the Treasury Department and the Service issued Notice 97–66, 1997–2 C.B. 328 (1997), on November 12, 1997. Notice 97–66 provides guidance that generally limits the aggregate U.S. gross-basis tax on a series of Securities Lending Transactions to no more than 30 percent of the amount equivalent to the dividend distribution on the underlying transferred security. To implement this limitation, Notice 97–66 provides a formulary method to calculate the amount of U.S. tax to be imposed on a foreign-to-foreign substitute dividend payment. Under this method,

> the amount of U.S. withholding tax to be imposed under §§ 1.871–7(b)(2) and 1.881–2(b)(2) with respect to a foreign-to-foreign payment will be the amount of the underlying dividend multiplied by a rate equal to the excess of the rate of U.S. withholding tax that would be applicable to U.S. source dividends paid by a U.S. person directly to the recipient of the substitute payment over the rate of U.S. withholding tax that would be applicable to U.S. source dividends paid by a U.S. person directly to the payor of the substitute payment.

The following example demonstrates the operation of this rule. If a borrower that is eligible under an income tax treaty for a reduced rate of tax equal to 15 percent on U.S.-source dividends makes a substitute dividend payment to a lender that is resident in a non-treaty jurisdiction subject to a tax of 30 percent on U.S.-source dividends, the amount of tax imposed on the substitute dividend payment under §§ 1.871–7(b)(2) and 1.881–2(b)(2) generally would be limited to 15 percent (*i.e.*, the payee's tax rate of 30 percent less the payor's rate of 15 percent). Notice 97–66 also provides in an example that if the securities lender's tax liability has already been reflected in prior withholding within a series of Securities Lending Transactions, the borrower, as a withholding agent, is permitted to reduce the lender's liability by such amount.

It has been widely reported that some taxpayers have relied on Notice 97–66 to avoid U.S. gross-basis taxation of foreign lenders of U.S. dividend-paying stocks in transactions undertaken primarily to enhance the after-tax yield of U.S. dividend-paying stocks held by foreign persons.[1]

On March 18, 2010, the Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, 124 Stat. 71 (2010) ("HIRE Act") was enacted. Section 541 of the HIRE Act added new § 871(l) to the Code, which provides that certain dividend equivalent payments are treated as U.S.-source dividends, effective for payments made on or after the date that is 180 days after the date of enactment. The term "dividend equivalent" is defined for this purpose to include "any substitute dividend made pursuant to a securities lending or sale-repurchase transaction that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States." § 871(l)(2)(A). Section 871(l)(6) authorizes the Secretary to reduce tax with respect to a chain of dividend equivalents "but only to the extent that the taxpayer can establish that such tax has been paid with respect to another dividend equivalent in such chain, or is not otherwise due, or as the Secretary determines is appropriate to address the role of financial intermediaries in such chain."

B. Modification and Withdrawal of Notice 97–66

Notice 97–66 is withdrawn effective for payments made on or after September 14, 2010 (the effective date of § 871(l)). Prior to September 14, 2010, taxpayers may continue to rely on Notice 97–66, except that Notice 97–66 is modified as follows: a withholding agent or foreign lender may not rely on Notice 97–66 when the withholding agent or foreign lender knows or has reason to know that a Securities Lending Transaction, or series of such transactions, has a principal purpose of reducing or eliminating the amount of gross-basis tax that would have been due in the absence of such transaction or transactions. For example, a person may not rely on Notice 97–66 to reduce or eliminate the amount of U.S. tax on the substitute dividend it is obligated to pay the foreign lender when it structures or participates in an arrangement whereby it: (1) borrows shares of a domestic corporation from a foreign person in a transaction described in § 1058 after a dividend declaration; (2) sells that stock to a related U.S. person before the ex-dividend date; and (3) enters into a total return swap agreement with that related person in order to hedge its risk. No inference is intended as to whether any transaction entered into prior to May 20, 2010, is eligible for the relief described in Notice 97–66, and the Service may challenge transactions under existing law, including by applying existing judicial doctrines, as appropriate.

II. PROPOSED WITHHOLDING AND REPORTING FRAMEWORK

The Treasury Department and the Service intend to issue regulations exercising the authority described in § 871(l)(6). These regulations will coordinate the tax imposed on substitute payments under § 871(l) and §§ 1.871–7(b)(2) and 1.881–2(b)(2) with the withholding and reporting requirements under §§ 1441, 1442 and 1461 and the regulations thereunder to ensure that the appropriate amount of tax is paid and reported. Generally, the regulations, as described below, are expected to replace the formulary approach previously adopted by Notice 97–66 with a documentation-based system under which withholding agents will be able to reduce withholding to the extent that withholding is shown to have been made on another substitute payment or dividend with respect to identical securities. Additionally,

[1] *See* STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 110TH CONG., REPORT ON DIVIDEND TAX ABUSE: HOW OFFSHORE ENTITIES DODGE TAXES ON U.S. STOCK DIVIDENDS (COMM. PRINT 2008).

to reduce instances of potential excessive or cascading taxation and to properly account for the role of financial intermediaries in Securities Lending Transactions, this proposed system is expected to exempt certain financial institutions from being subject to withholding at source on receipt of substitute dividend payments provided that they assume responsibility and liability for properly withholding, reporting, depositing, and paying U.S. tax with respect to substitute dividend payments. This system will also permit the Service to administer compliance by market participants more effectively by disqualifying noncompliant taxpayers from eligibility for the relief provided in this notice in appropriate cases.

A. Substitute Dividend Payments to a "Qualified Securities Lender"

Treatment of Withholding Agent. The regulations are expected to provide that a withholding agent making a substitute dividend payment to a financial institution that meets the regulatory definition of a Qualified Securities Lender will not be required to withhold U.S. tax with respect to such payment. Part 2.A.ii describes the certifications required to be made by a Qualified Securities Lender to a withholding agent in order to relieve a withholding agent of its obligation to withhold on a substitute dividend.

Treatment of Qualified Securities Lender. The regulations will coordinate the obligation of a Qualified Securities Lender to withhold on substitute dividend payments that it makes, pay and deposit tax on substitute dividends it receives, and report on substitute dividends it makes (on behalf of itself or any other person). The regulations are expected to define these obligations in terms of two distinct categories of substitute dividends that Qualified Securities Lenders pay or receive.

In circumstances where a Qualified Securities Lender receives a substitute dividend payment (the "first substitute dividend payment") and is obligated to make an offsetting substitute dividend payment with respect to identical securities (the "second substitute dividend payment"), the regulations are expected to provide that a Qualified Securities Lender: (A) will not be liable for U.S. gross-basis tax on the first substitute dividend payment under § 871(a) or 881(a); and (B) must properly withhold under §§ 1441 and 1442 and report with respect to the second substitute dividend payment.

In circumstances where a Qualified Securities Lender receives a substitute dividend payment for which it has no obligation to make an offsetting substitute dividend payment with respect to identical securities, the Qualified Securities Lender remains liable for tax under § 871(a) or 881(a) by virtue of the receipt of such substitute dividend payment.

The Service intends to monitor Qualified Securities Lenders for compliance with all applicable rules described in this notice and may revoke an institution's status as a Qualified Securities Lender for noncompliance. Such noncompliance may include, for example, circumstances in which an institution structures or participates in arrangements designed to facilitate the avoidance of U.S. gross-basis taxation by foreign persons that hold or held U.S. equities, as well as circumstances in which an institution does not withhold and deposit tax at the proper rate when it acts as a custodian on behalf of both a borrower and lender in the same Securities Lending Transaction.

i. Definition of Qualified Securities Lender

For purposes of the relief described above, the regulations are expected to provide that a foreign financial institution is a Qualified Securities Lender only if it satisfies all of the following conditions:

- it is a bank, custodian, broker-dealer, or clearing organization that is subject to regulatory supervision by a governmental authority in the jurisdiction in which it was created or organized, and is regularly engaged in a trade or business that includes the borrowing of securities of domestic corporations (as defined in § 7701(a)(4)) from, and lending of securities of domestic corporations to, its unrelated customers;
- it is subject to audit by the Service under § 7602 or, in the case of a Qualified Intermediary (QI) that appropriately amends its QI agreement with the Service, by an external auditor. Further guidance will specify the requirements of such an amendment to the QI agreement. In general, however, the amendment will require the QI to report, withhold, deposit, and pay U.S. tax as described in Parts II.A and D of this notice; and
- it files an annual statement on a form prescribed by the Service certifying that it satisfies the conditions necessary to be a Qualified Securities Lender.

ii. *Certifications by a Qualified Securities Lender*

As noted above, the regulations are expected to relieve a withholding agent of its liability to withhold U.S. tax with respect to any substitute dividend paid to a Qualified Securities Lender only if the withholding agent receives a written certification from the Qualified Securities Lender, either on a form prescribed by the Service or as otherwise provided by regulation. This certification must include a statement that the recipient of a substitute dividend is a Qualified Securities Lender and that, with respect to any substitute dividend it receives from the withholding agent, it will withhold and remit or pay the proper amount of U.S. gross-basis tax with respect to substitute dividend payments that it receives or makes.

B. Credit Forward of Prior Withholding

The Treasury Department and the Service believe that the vast majority of instances of excessive or cascading taxation will be relieved through the Qualified Securities Lender rules described above. To address remaining instances of excessive or cascading taxation not addressed by the Qualified Securities Lender rules, the regulations are expected to provide a credit forward system, as described below.

i. *Availability of credit for prior withholding*

The regulations are expected to provide that withholding agents may limit the aggregate U.S. gross-basis tax within a series of Securities Lending Transactions to the amount of U.S. gross-basis tax, if any, applicable to the foreign taxpayer (other than in the case of a Qualified Securities Lender that is obligated to make an offsetting substitute dividend payment) bearing

the highest rate of U.S. gross-basis tax on either a substitute or actual dividend with respect to the underlying security transferred in the series. As a result, the aggregate taxes paid in such transactions should not exceed the 30 percent statutory rate applicable to U.S.-source dividends paid to foreign persons. The regulations are expected to provide that withholding agents may relieve excessive tax on substitute dividends by reducing withholding on a substitute dividend payment that the withholding agent is obligated to make by an amount not to exceed the amount that has been previously withheld within the same series of Securities Lending Transactions, but only to the extent that there is sufficient evidence that tax was actually withheld on a prior dividend and/or substitute dividend paid to the withholding agent or a prior withholding agent within the same such series. No payee in a series of Securities Lending Transactions may claim a refund (or claim a credit against any other liability) solely because a prior payee in the same series was subjected to a higher rate of gross-basis U.S. tax. Moreover, no taxpayer or withholding agent in a series of Securities Lending Transactions may credit any tax withheld with respect to a substitute dividend payment in such series against any tax imposed with respect to a substitute dividend payment in a different series of Securities Lending Transactions.

ii. Substantiation of Prior Withholding

The regulations are expected to provide that sufficient evidence of prior withholding will be deemed to exist where there is written documentation that identifies amounts previously withheld by another withholding agent with respect to actual dividend distributions or substitute dividends in the same series of Securities Lending Transactions or as otherwise prescribed by the Service in future guidance. For example, the regulations are expected to provide that a withholding agent may presume that tax has been withheld by a prior withholding agent in a series of Securities Lending Transactions if that agent: (1) receives a substitute dividend net of U.S. withholding taxes; (2) receives a written statement from the immediately prior withholding agent setting out the amount of such taxes; (3) identifies the person who withheld such tax and the recipient of the payment against which such tax was withheld; and (4) does not know or have reason to know that the written statement is unreliable. For these determinations, a withholding agent may not rely upon evidence of a sale of the underlying security as a basis to determine that tax has been paid or withheld.

C. Anti-Abuse

Finally, the regulations are expected to provide that a withholding agent or a Qualified Securities Lender may not rely on any of the foregoing rules (including any certifications provided by a Qualified Securities Lender) when the withholding agent or Qualified Securities Lender knows or has reason to know that a Securities Lending Transaction, or series of such transactions, has a principal purpose of reducing or eliminating the amount of U.S. gross-basis tax that would have been due in the absence of such transaction or transactions. In such a case, a withholding agent or Qualified Securities Lender must withhold, and the recipient of such payment is subject to U.S. gross-basis tax, at 30 percent (subject to reduction under an applicable income tax treaty) on each substitute dividend payment with respect to such transaction.

D. Other Considerations—Information Reporting of Substitute Payments

In cases in which a withholding agent (including a Qualified Securities Lender) makes a substitute dividend payment and, in reliance on the regulations, (1) reduces the withholding or (2) is exempted from withholding, the withholding agent should include on Form 1042 and Form 1042–S: (a) the gross amount of the substitute dividend to which the recipient would have otherwise been entitled before consideration of any withholding tax obligations; and (b) the amount of tax withheld by the withholding agent and shown to have been withheld by other withholding agents in the series of Securities Lending Transactions based on the documentation and information as described above. In addition, a withholding agent (including a Qualified Securities Lender) that makes a substitute dividend payment to a United States person as defined in § 7701(a)(30) will be required to report and withhold to the extent required under Chapter 61 and § 3406.

III. TRANSITION RULE

A. *Summary and General Transition Rule*

The Treasury Department and the Service anticipate that the regulatory framework outlined in Part II of this notice will be effective for transactions entered into on or after January 1, 2012. Until such regulations are issued, and after September 14, 2010 (the "transition period"), § 871(l) will apply with the potential for U.S. tax due on a series of Securities Lending Transactions that exceeds 30 percent in the aggregate. In order to avoid excessive or cascading tax in these situations, withholding agents may rely on the transition rules described in this Part.

Generally, the transition rules described in this Part III provide that the maximum aggregate U.S. gross-basis tax due, if any, with respect to a series of Securities Lending Transactions and any related dividend payment is the amount determined by the tax rate paid by the foreign taxpayer (other than in the case of a Qualified Securities Lender that is obligated to make an offsetting substitute dividend payment) bearing the highest rate of U.S. gross-basis tax in the series. Accordingly, the aggregate U.S. gross-basis taxes paid in such transactions generally should not exceed the 30 percent statutory rate applicable to U.S.-source dividends paid to foreign persons.

B. *Receipt of Net Payments*

A withholding agent that is obligated to make a substitute dividend payment pursuant to a Securities Lending Transaction may presume that U.S. tax has been paid in an amount equal to the amount implied by the net payment if all of the following are satisfied:

- The withholding agent receives a substitute dividend or dividend payment with respect to identical securities that reflects a reduction for withholding of U.S. gross-basis tax;
- The withholding agent does not know or have reason to know that tax was not withheld and deposited or paid. For this purpose, a withholding agent has a reason to know that tax was not withheld if, for example, the amount of any lending fee or similar fee is increased directly or indirectly, in whole

or in part, by the difference between the gross amount of the substitute dividend and the net amount received; and

- The withholding agent is a person subject to audit under § 7602, or in the case of a QI, by an external auditor.

No payee in a series of Securities Lending Transactions may claim a refund (or claim a credit against any other liability) solely because a prior payee in the same series was subjected to a higher rate of gross-basis U.S. tax. Moreover, no taxpayer or withholding agent in a series of Securities Lending Transactions may credit any tax withheld with respect to a substitute dividend payment in such series against any tax imposed with respect to a substitute dividend payment in a different series of Securities Lending Transactions.

C. *Application of Qualified Securities Lender Rules*

During the transition period, withholding agents may adopt a system that reasonably implements the principles of the Qualified Securities Lender system described in Part II of this notice. In particular, during the transition period, a withholding agent is not required to withhold on a substitute dividend payment made to a Qualified Securities Lender if the withholding agent receives, at least annually, a statement from its counterparty that substantially complies with the certification requirement described in Part II.A.ii of this notice. A financial institution may make such a certification only if it reasonably determines that it meets the requirements to qualify as a Qualified Securities Lender described in Part II.A.i of this notice (without regard to the requirement that a Qualified Securities Lender file an annual statement with the Service). It is anticipated that future guidance will provide that all Qualified Securities Lenders taking advantage of the transition relief described in this Part may be required to identify themselves to the Service (in a manner to be specified) before the end of calendar year 2010. A QI that provides such a certification will be deemed to have agreed to amend its QI agreement for these purposes as necessary to report, withhold, deposit, and pay U.S. tax as described in Part II.A of this notice.

D. *Anti-Abuse*

Withholding agents may not rely on the transition relief described in Part III of this notice with respect to a Securities Lending Transaction or series of such transactions that are entered into with a principal purpose of reducing or eliminating the aggregate amount of U.S. tax that would have been due in the absence of such transaction or series of transactions. A financial institution that is determined to have structured or engaged in one or more transactions described in the preceding sentence on or after May 20, 2010, will not qualify as a Qualified Securities Lender for a period of 5 years from the date of such determination.

E. *Other Considerations*

A Qualified Securities Lender may use any reasonable method, consistently applied, to determine which securities within a pool of fungible securities available to borrow have actually been borrowed and lent.

Withholding agents will be required to perform information reporting as specified in Part II.D above.

F. *Extensions*

The Treasury Department and the Service believe that administrative relief is appropriate to ensure that withholding agents have sufficient time to make the operational changes necessary to comply with § 541 of the HIRE Act and the provisions of this notice. Therefore, to the extent that § 871(l) applies to any substitute dividend payments in respect of any transaction described in § 871(l)(2)(A), withholding agents are hereby granted an automatic six-month extension of time to file information returns pursuant to § 1.1461–1(c) with respect to the calendar year 2010. However, the time for filing information returns pursuant to § 1.1461–1(c) shall not be extended beyond the date on which the withholding agent provides a copy of the return to the recipient. In addition, withholding agents are hereby granted an automatic extension for making deposits of withheld tax from such substitute dividend payments until January 31, 2011, for the calendar year 2010. The Treasury Department and the Service believe that the administrative relief provided by this notice is in the best interests of sound tax administration.

IV. EFFECTIVE DATES

The modification of Notice 97–66 described in Part I is effective for amounts paid on or after May 20, 2010 and before September 14, 2010. The transition rules described in Part III are effective for amounts paid on or after September 14, 2010.

V. 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 1545–1566.

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 control number.

The collection of information contained in this notice is in Part III. The information is required to prevent excessive taxation under §871(l) during the transition period. The information will be used for the same purpose described in the preceding sentence. The collections of information are required to obtain a benefit. The likely respondents are businesses or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 1,000 hours.

The estimated annual burden per respondent/recordkeeper varies from 1 minute to 15 minutes, depending on individual circumstances, with an estimated average of 10 minutes. The estimated number of respondents and/or recordkeepers is 6,000.

The estimated frequency of responses (used for reporting requirements only) is once.

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.

VI. EFFECT ON OTHER DOCUMENTS

Notice 97–66 is modified as provided in Part I.

VII. REQUEST FOR COMMENTS

The Treasury Department and the Service invite comments on the guidance described in this notice. In particular, comments are requested on the following issues.

1. The definition of a Qualified Securities Lender.
2. The treatment of substitute dividends paid to a Qualified Securities Lender where that entity holds the relevant position in a proprietary account.
3. Whether additional rules are required to address abusive Securities Lending Transactions that avoid U.S. tax in addition to the anti-abuse regulation described above.
4. The treatment of substitute dividends paid with respect to securities transferred from a commingled account containing securities held by a Qualified Securities Lender in its proprietary capacity and other securities held in connection with transactions for customers.
5. Whether a Qualified Intermediary with Qualified Securities Lender status (a "Lender QI") should be required to provide the withholding rate pool information of its customers to another Qualified Intermediary (a "Borrower QI") that has borrowed securities in a Securities Lending Transaction. Whether a Borrower QI should be required to withhold and carry out information reporting on a substitute dividend payment made to a Lender QI based upon the withholding information provided by a Lender QI with respect to its customers.
6. The definition of a series of Securities Lending Transactions, and how related securities loans in a series should be identified, including appropriate methods pursuant to which a Qualified Securities Lender may determine which securities within a pool of fungible securities are attributable to particular Securities Lending Transactions.

The principal authors of this notice are Peter Merkel and John Sweeney of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Peter Merkel or John Sweeney at (202) 622–3870 (not a toll-free call).

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26 CFR 601.601: Rules and regulations.
(Also Part I, §§ 25, 103, 143; 1.25–4T, 1.103–1, 6a.103A–2.)

Rev. Proc. 2010–23

SECTION 1. PURPOSE

This revenue procedure provides guidance with respect to the United States and area median gross income figures that are to be used by issuers of qualified mortgage bonds, as defined in § 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in § 25(c), in computing the housing cost/income ratio described in § 143(f)(5).

SECTION 2. BACKGROUND

.01 Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(e) provides that the term "qualified bond" includes any private activity bond that (1) is a qualified mortgage bond, (2) meets the applicable volume cap requirements under § 146, and (3) meets the applicable requirements under § 147.

.02 Section 143(a)(1) provides that the term "qualified mortgage bond" means a bond that is issued as part of a "qualified mortgage issue". Section 143(a)(2)(A) provides that the term "qualified mortgage issue" means an issue of one or more bonds by a state or political subdivision thereof, but only if (i) all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences; (ii) the issue meets the requirements of subsections (c), (d), (e), (f), (g), (h), (i), and (m)(7) of § 143; (iii) the issue does not meet the private business tests of paragraphs (1) and (2) of § 141(b); and (iv) with respect to amounts received more than 10 years after the date of issuance, repayments of $250,000 or more of principal on financing provided by the issue are used not later than the close of the first semi-annual period beginning after the date the prepayment (or complete repayment) is received to redeem bonds that are part of the issue.

.03 Section 143(f) imposes eligibility requirements concerning the maximum income of mortgagors for whom financing may be provided by qualified mortgage bonds. Section 25(c)(2)(A)(iii)(IV) provides that recipients of mortgage credit certificates must meet the income requirements of § 143(f). Generally, under §§ 143(f)(1) and 25(c)(2)(A)(iii)(IV), these income requirements are met only if all owner-financing under a qualified mortgage bond and all certified indebtedness amounts under a mortgage credit certificate program are provided to mortgagors whose family income is 115 percent or less of the applicable median family income. Under § 143(f)(6), the income limitation is reduced to 100 percent of the applicable median family income if there are fewer than three individuals in the family of the mortgagor.

.04 Section 143(f)(4) provides that the term "applicable median family income" means the greater of (A) the area median gross income for the area in which the residence is located, or (B) the statewide median gross income for the state in which the residence is located.

.05 Section 143(f)(5) provides for an upward adjustment of the income limitations in certain high housing cost areas. Under § 143(f)(5)(C), a high housing cost area is a statistical area for which the housing cost/income ratio is greater than 1.2. The housing cost/income ratio is determined under § 143(f)(5)(D) by dividing (a) the applicable housing price ratio by (b) the ratio that the area median gross income bears to the median gross income for the United States. The applicable housing price ratio is the new housing price ratio (new housing average purchase price for the area divided by the new housing average purchase price for the United States) or the existing housing price ratio (existing housing average area purchase price divided by the existing housing average purchase price for the United States), whichever results in the housing cost/in-