

ing for federal tax purposes, and Z ceases its separate legal existence for all purposes. Paragraph (b)(1)(iii) of this section does not apply to prevent the transaction from qualifying as a statutory merger or consolidation for purposes of section 368(a)(1)(A) because each of Z, Y, and X is a domestic entity. Moreover, the deemed transfer of the assets of U in exchange for U stock does not cause the transaction to fail to qualify as a statutory merger or consolidation. See §368(a)(2)(C). Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 4. Triangular merger of a target corporation into a disregarded entity. (i) The facts are the same as in *Example 2*, except that V owns 100 percent of the outstanding stock of Y and, in the merger of Z into X, the Z shareholders exchange their stock of Z for stock of V. In the transaction, Z transfers substantially all of its properties to X.

(ii) The transaction is not prevented from qualifying as a statutory merger or consolidation under section 368(a)(1)(A), provided the requirements of section 368(a)(2)(D) are satisfied. Because the assets of X are treated for federal tax purposes as the assets of Y, Y will be treated as acquiring substantially all of the properties of Z in the merger for purposes of determining whether the merger satisfies the requirements of section 368(a)(2)(D). As a result, the Z shareholders that receive stock of V will be treated as receiving stock of a corporation that is in control of Y, the combining entity of the transferee unit that is the acquiring corporation for purposes of section 368(a)(2)(D). Accordingly, the merger will satisfy the requirements of section 368(a)(2)(D).

Example 5. Merger of a target corporation into a disregarded entity owned by a partnership. (i) The facts are the same as in *Example 2*, except that Y is organized as a partnership under the laws of State W and is classified as a partnership for federal tax purposes.

(ii) The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section. All of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, do not become the assets and liabilities of one or more members of a transferee unit because neither X nor Y qualifies as a combining entity. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 6. Merger of a disregarded entity into a corporation. (i) Under State W law, X merges into Z. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of X (but not the assets and liabilities of Y other than those of X) become the assets and liabilities of Z and X's separate legal existence ceases for all purposes.

(ii) The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because all of the assets and liabilities of a transferor unit do not become the assets and liabilities of one or more members of the transferee unit. The transaction also does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because X does not qualify as a combining entity. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 7. Merger of a corporation into a disregarded entity in exchange for interests in the disregarded entity. (i) Under State W law, Z merges into

X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z's separate legal existence ceases for all purposes. In the merger of Z into X, the Z shareholders exchange their stock of Z for interests in X so that, immediately after the merger, X is not disregarded as an entity separate from Y for federal tax purposes. Following the merger, pursuant to §301.7701-3(b)(1)(i) of this chapter, X is classified as a partnership for federal tax purposes.

(ii) The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because immediately after the merger X is not disregarded as an entity separate from Y and, consequently, all of the assets and liabilities of Z, the combining entity of the transferor unit, do not become the assets and liabilities of one or more members of a transferee unit. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 8. Merger transaction preceded by distribution. (i) Z operates two unrelated businesses, Business P and Business Q, each of which represents 50 percent of the value of the assets of Z. Y desires to acquire and continue operating Business P, but does not want to acquire Business Q. Pursuant to a single plan, Z sells Business Q for cash to parties unrelated to Z and Y in a taxable transaction, and then distributes the proceeds of the sale *pro rata* to its shareholders. Then, pursuant to State W law, Z merges into Y. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z related to Business P become the assets and liabilities of Y and Z's separate legal existence ceases for all purposes. In the merger, the Z shareholders exchange their Z stock for Y stock. Prior to the transaction, Z is not treated as owning any assets of an entity that is disregarded as an entity separate from its owner for federal tax purposes.

(ii) The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, become the assets and liabilities of Y, the combining entity and sole member of the transferee unit, and Z ceases its separate legal existence for all purposes. Paragraph (b)(1)(iii) of this section does not apply to prevent the transaction from qualifying as a statutory merger or consolidation for purposes of section 368(a)(1)(A) because each of Z and Y is a domestic entity. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

(v) *Effective dates.* This paragraph (b)(1) applies to transactions occurring on or after January 24, 2003. Taxpayers, however, may apply these regulations in whole, but not in part, to transactions occurring before January 24, 2003, provided that, if the taxpayer is the acquiring corporation (or a shareholder of the acquiring corporation whose tax treatment of the transaction reflects the tax treatment by the acquiring corporation, such as a shareholder of an

acquiring S corporation), the target corporation (and the shareholders of the target corporation whose tax treatment of the transaction reflects the tax treatment by the target corporation) also applies these regulations in whole, but not in part, to the transaction, and if the taxpayer is the target corporation (or a shareholder of the target corporation whose tax treatment of the transaction reflects the tax treatment by the target corporation), the acquiring corporation (and the shareholders of the acquiring corporation whose tax treatment of the transaction reflects the tax treatment by the acquiring corporation) also applies these regulations in whole, but not in part, to the transaction. For all other transactions, see §1.368-2(b)(1) as in effect before January 24, 2003 (See 26 CFR part 1, revised April 1, 2002).

(b)(2) through (k) [Reserved]. For further guidance, see §1.368-2(b)(2) through (k).

David A. Mader,
Assistant Deputy Commissioner of
Internal Revenue.

Approved January 17, 2003.

Pamela F. Olson,
Assistant Secretary of
the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on January 23, 2003, 8:45 a.m., and published in the issue of the Federal Register for January 24, 2003, 68 F.R. 3384)

Section 1041.—Transfers of Property Between Spouses or Incident to Divorce

26 CFR 1.1041-1T: Treatment of transfers of property between spouses or incident to divorce (temporary).

T.D. 9035

DEPARTMENT OF THE
TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Constructive Transfers and
Transfers of Property to a
Third Party on Behalf of a
Spouse

AGENCY: Internal Revenue Service (IRS),
Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to the tax treatment of redemptions, during marriage or incident to divorce, of stock in a corporation owned by a spouse or former spouse.

DATE: *Effective Date:* These regulations are effective January 13, 2003.

Applicability Date: These regulations are applicable to redemptions of stock on or after January 13, 2003, that are pursuant to instruments in effect after January 13, 2003. These regulations are also applicable to redemptions before January 13, 2003, or that are pursuant to instruments in effect before January 13, 2003, if the spouses or former spouses execute a written agreement on or after August 3, 2001, that satisfies the requirements of §1.1041-2(c)(1) or (2).

FOR FURTHER INFORMATION CONTACT: Edward C. Schwartz at (202) 622-4960 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has 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 1545-1751. Responses to this collection of information are required for certain taxpayers to redeem stock in a corporation and utilize the special rule in §1.1041-2(c) of these regulations.

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 assigned by the Office of Management and Budget.

The estimated annual burden per respondent/recordkeeper varies from 20 minutes to one hour, depending on individual circumstances, with an estimated average of 30 minutes.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Of-

ficer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this 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.

Background

On August 3, 2001, the IRS and Treasury Department published in the **Federal Register** a notice of proposed rulemaking under section 1041 relating to certain redemptions, during marriage or incident to divorce, of stock in a corporation owned by a spouse or former spouse (REG-107151-00, 2001-2 C.B. 370 [66 FR 40659]). Written and electronic comments were solicited, and a public hearing was scheduled for December 14, 2001. Several comments were received and are discussed below. Because no requests to speak were timely received, the public hearing was cancelled. After consideration of all comments received, the proposed regulations under section 1041 are adopted as revised by this Treasury decision.

Explanation and Summary of Comments

1. Special Rules in Cases of Written Agreements Between the Spouses

The proposed regulations provided generally that if a corporation redeemed stock owned by a transferor spouse and the redemption resulted in a constructive distribution to the nontransferor spouse under applicable tax law, then the redemption would be taxable to the nontransferor spouse as if the nontransferor spouse had actually received the redemption proceeds. The proposed regulations contained a special rule in §1.1041-2(c) allowing the spouses the option of treating the redemption as resulting in a constructive distribution to the nontransferor spouse, and therefore taxable to the nontransferor spouse, even if the redemption would not result in a constructive distribution to the nontransferor spouse under applicable tax law. The proposed regulations provided that the spouses could elect the special rule by providing in the divorce or separation instrument, or other written agreement, that

the spouses must file their federal income tax returns in a manner that reflects that the transferor spouse transferred the redeemed stock to the nontransferor spouse in exchange for the redemption proceeds and the corporation redeemed the stock from the nontransferor spouse in exchange for the redemption proceeds. The proposed regulations also provided that the special rule would be effective for written agreements executed on or after August 3, 2001, that met these requirements.

Commentators expressed concern that the proposed regulations contained no provision addressing the situation where the redemption results in a constructive distribution to the nontransferor spouse under applicable tax law, but the spouses nevertheless would like to agree that the redemption will be treated as a redemption distribution to the transferor spouse. They suggested that the final regulations expand the special rule in §1.1041-2(c) to allow the spouses to agree in the divorce or separation instrument, or other valid written agreement, that the redemption will be taxable to the transferor spouse notwithstanding that the redemption might otherwise result in a constructive distribution to the nontransferor spouse under applicable tax law.

The IRS and Treasury Department believe that this suggestion is consistent with the policy of section 1041 and its legislative history, which is to provide flexibility to spouses and former spouses concerning the structuring of their property transfers during marriage and incident to divorce. Accordingly, this suggestion has been adopted in §1.1041-2(c) of the final regulations. *New Example 2* in §1.1041-2(d) illustrates the application of this new special rule.

The manner of electing the special rule also has been modified somewhat in the final regulations. Under the final regulations, the spouses can elect the special rule by expressly providing, in a divorce or separation instrument or other valid written agreement, that expressly supersedes any other instrument or agreement concerning the purchase, sale, redemption, or other disposition of the stock that is the subject of the redemption, their mutual intent concerning whether the redemption should be treated as a redemption distribution to the transferor spouse or to the nontransferor spouse. The IRS and Treasury Department

will treat a divorce or separation instrument or other valid written agreement executed on or after August 3, 2001, and before May 13, 2003, that meets the requirements of the special rule of the proposed regulations as also meeting the requirements of the special rule in paragraph (c)(2) of the final regulations.

2. Constructive Distribution Standard

Some commentators also expressed concern that taxpayers and divorce practitioners may not be aware of the situations in which a redemption of stock owned by the transferor spouse could result in a constructive distribution to the nontransferor spouse under applicable tax law. They therefore suggested that the final regulations either provide that the redemption will be treated as a redemption distribution to the transferor spouse regardless of applicable tax law, unless the spouses provide otherwise in a written agreement and file their federal income tax returns accordingly, or provide specific definitions and examples of situations in which a redemption would result in a constructive distribution to the nontransferor spouse under applicable tax law.

The IRS and Treasury Department continue to believe that the approach in the proposed regulations is appropriate. Under existing tax law, a redemption of stock owned by one shareholder may result in a constructive distribution to another shareholder if such nonredeeming shareholder has a primary and unconditional obligation to purchase the redeeming shareholder's stock. See Rev. Rul. 69-608, 1969-2 C.B. 42, *Wall v. United States*, 164 F.2d 462 (4th Cir. 1947), and *Sullivan v. United States*, 363 F.2d 724 (8th Cir. 1966). This "primary and unconditional obligation" standard applies to all redemptions, including those involving stock of closely held corporations by spouses or former spouses. A rule that provides that a redemption of stock owned by the transferor spouse will always be treated as a redemption distribution to the transferor spouse would be inconsistent with this established law. Furthermore, if taxpayers and divorce practitioners are uncertain about the application of the "primary and unconditional obligation" standard, they may take advantage of the special rules of §1.1041-2(c), which permit spouses to avoid any question of whether a redemption results in a constructive distribution to the nontrans-

feror spouse under applicable tax law relating to the primary and unconditional obligation standard by providing in a written agreement which spouse will bear the tax consequences of the redemption.

3. Withdrawal of §1.1041-1T(c), Q&A-9

Section 1.1041-1T(c), Q&A-9, of the temporary Income Tax Regulations provides that there are three situations in which a transfer of property to a third party on behalf of a spouse or former spouse will qualify under section 1041 (provided all other requirements of that section are met): (1) if such transfer is required by the divorce or separation instrument; (2) if the transfer is pursuant to a written request of the other spouse; and (3) where the transferor spouse receives a written consent or ratification from the nontransferor spouse. Under Q&A-9, a transfer of property made to a third party on behalf of a spouse is treated first as a deemed transfer of the property made directly to the nontransferor spouse in a transfer to which section 1041 applies, and then as a deemed transfer of the property from the nontransferor spouse to the third party in a transaction to which section 1041 does not apply.

Two commentators recommended that Q&A-9 be withdrawn. They suggested that retaining that provision would lead to confusion since it would apply to all transfers of property other than stock redemptions while this final regulation would apply only to stock redemptions. Another commentator advocated replacing existing Q&A-9 with a single standard applicable to all transfers of property to third parties under which the tax consequences of the transfer would follow the transferor's form unless the spouses agreed in writing otherwise.

The "on behalf of" standard has not led to the same confusion and litigation outside the area of stock redemptions because, in such cases, it does not conflict with any other standard of tax law. See, e.g., *Ingham v. United States*, 167 F.3d 1240 (9th Cir. 1999). In addition, as discussed above, a single standard applicable to all transfers of property to third parties under which the tax consequences of the transfer would follow the transferor's form would be inconsistent with the primary and unconditional obligation standard applicable to stock redemptions under existing tax law. Consequently, the IRS and Treasury Department

continue to believe that the final regulations should be limited to stock redemptions and that Q&A-9 should not be withdrawn.

4. Use of IRS Form to Designate Intent

One commentator proposed that the final regulations include a requirement that the spouses or former spouses attach a form to their federal income tax returns showing which spouse or former spouse has the tax consequences of the redemption. After careful consideration, the IRS and Treasury Department have concluded that requiring spouses, and particularly spouses who have divorced or are divorcing, to complete and file an additional form in order to obtain the result of the special rules would unnecessarily increase the administrative burden on taxpayers and on the IRS. The divorce or separation instrument, or other valid written agreement of the spouses, provides adequate evidence of the spouses' intent regarding which spouse has the tax consequences of the redemption.

5. Legal Guardians and/or Executors of Estates of Spouses

One commentator suggested that the final regulations provide specific authority for a legal guardian of a spouse or former spouse or the executor of a spouse's or former spouse's estate to elect the application of one of the special rules of §1.1041-2(c). However, a legal guardian, custodian, or executor of an estate that has the general authority to act on behalf of a spouse or former spouse (or his or her estate) for federal income tax purposes needs no additional or special authority to elect one of the special rules under §1.1041-2(c). Accordingly, this suggestion has not been adopted.

6. Other Changes

In an effort to improve the clarity of the final regulations, the order of the two paragraphs in §1.1041-2(a) has been reversed and conforming changes have been made in the remainder of the final regulations. Also, the final regulations remove the provision of the proposed regulations that would have limited their application to transactions in which both spouses or former spouses own stock immediately before or after the redemption. On further reflection, the IRS and Treasury Department believe it is appropriate to apply the regu-

lations to all stock redemptions, regardless of whether both spouses own stock of the corporation before or after the redemption.

7. Effective Date

One comment was received suggesting that the effective date provision of the final regulations be changed to include all stock redemptions that were pending on the day the proposed regulations were issued (August 2, 2001) and to include all cases involving stock redemptions at issue on that date at any level of audit, review, appeal, or collection by the IRS or before the Tax Court or any other federal court. It was argued that this proposal would be consistent with the current state of the law and would resolve numerous cases involving taxpayers and the IRS. Adopting this suggestion would have the effect of making the application of the final regulations retroactive. Apart from the special rules of §1.1041-2(c), which are based upon the stated intent of the spouses, the IRS and Treasury do not believe it is appropriate to apply the final regulations retroactively. Therefore, the final regulations do not adopt this suggestion.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Edward C. Schwartz of the Office of the Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

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. In §1.1041-1T, paragraph (c) is amended by adding a sentence at the end of A-9 to read as follows:

§1.1041-1T Treatment of transfers of property between spouses or incident to divorce (temporary).

* * * * *

(c) * * *

A-9: * * * This A-9 shall not apply to transfers to which §1.1041-2 applies.

* * * * *

Par. 3. Section 1.1041-2 is added to read as follows:

§1.1041-2 Redemptions of stock.

(a) *In general—(1) Redemptions of stock not resulting in constructive distributions.* Notwithstanding Q&A-9 of §1.1041-1T(c), if a corporation redeems stock owned by a spouse or former spouse (transferor spouse), and the transferor spouse's receipt of property in respect of such redeemed stock is not treated, under applicable tax law, as resulting in a constructive distribution to the other spouse or former spouse (nontransferor spouse), then the form of the stock redemption shall be respected for federal income tax purposes. Therefore, the transferor spouse will be treated as having received a distribution from the corporation in redemption of stock.

(2) *Redemptions of stock resulting in constructive distributions.* Notwithstanding Q&A-9 of §1.1041-1T(c), if a corporation redeems stock owned by a transferor spouse, and the transferor spouse's receipt of property in respect of such redeemed stock is treated, under applicable tax law, as resulting in a constructive distribution to the nontransferor spouse, then the redeemed stock shall be deemed first to be transferred by the transferor spouse to the nontransferor spouse and then to be transferred by the nontransferor spouse to

the redeeming corporation. Any property actually received by the transferor spouse from the redeeming corporation in respect of the redeemed stock shall be deemed first to be transferred by the corporation to the nontransferor spouse in redemption of such spouse's stock and then to be transferred by the nontransferor spouse to the transferor spouse.

(b) *Tax consequences—(1) Transfers described in paragraph (a)(1) of this section.* Section 1041 will not apply to any of the transfers described in paragraph (a)(1) of this section. See section 302 for rules relating to the tax consequences of certain redemptions; redemptions characterized as distributions under section 302(d) will be subject to section 301 if received from a Subchapter C corporation or section 1368 if received from a Subchapter S corporation.

(2) *Transfers described in paragraph (a)(2) of this section.* The tax consequences of each deemed transfer described in paragraph (a)(2) of this section are determined under applicable provisions of the Internal Revenue Code as if the spouses had actually made such transfers. Accordingly, section 1041 applies to any deemed transfer of the stock and redemption proceeds between the transferor spouse and the nontransferor spouse, provided the requirements of section 1041 are otherwise satisfied with respect to such deemed transfer. Section 1041, however, will not apply to any deemed transfer of stock by the nontransferor spouse to the redeeming corporation in exchange for the redemption proceeds. See section 302 for rules relating to the tax consequences of certain redemptions; redemptions characterized as distributions under section 302(d) will be subject to section 301 if received from a Subchapter C corporation or section 1368 if received from a Subchapter S corporation.

(c) *Special rules in case of agreements between spouses or former spouses—(1) Transferor spouse taxable.* Notwithstanding applicable tax law, a transferor spouse's receipt of property in respect of the redeemed stock shall be treated as a distribution to the transferor spouse in redemption of such stock for purposes of paragraph (a)(1) of this section, and shall not be treated as resulting in a constructive distribution to the nontransferor spouse for purposes of paragraph (a)(2) of this section, if a divorce or separation instrument,

or a valid written agreement between the transferor spouse and the nontransferor spouse, expressly provides that—

(i) Both spouses or former spouses intend for the redemption to be treated, for federal income tax purposes, as a redemption distribution to the transferor spouse; and

(ii) Such instrument or agreement supersedes any other instrument or agreement concerning the purchase, sale, redemption, or other disposition of the stock that is the subject of the redemption.

(2) *Nontransferor spouse taxable.* Notwithstanding applicable tax law, a transferor spouse's receipt of property in respect of the redeemed stock shall be treated as resulting in a constructive distribution to the nontransferor spouse for purposes of paragraph (a)(2) of this section, and shall not be treated as a distribution to the transferor spouse in redemption of such stock for purposes of paragraph (a)(1) of this section, if a divorce or separation instrument, or a valid written agreement between the transferor spouse and the nontransferor spouse, expressly provides that—

(i) Both spouses or former spouses intend for the redemption to be treated, for federal income tax purposes, as resulting in a constructive distribution to the nontransferor spouse; and

(ii) Such instrument or agreement supersedes any other instrument or agreement concerning the purchase, sale, redemption, or other disposition of the stock that is the subject of the redemption.

(3) *Execution of agreements.* For purposes of this paragraph (c), a divorce or separation instrument must be effective, or a valid written agreement must be executed by both spouses or former spouses, prior to the date on which the transferor spouse (in the case of paragraph (c)(1) of this section) or the nontransferor spouse (in the case of paragraph (c)(2) of this section) files such spouse's first timely filed federal income tax return for the year that includes the date of the stock redemption, but no later than the date such return is due (including extensions).

(d) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. Corporation X has 100 shares outstanding. A and B each own 50 shares. A and B divorce. The divorce instrument requires B to purchase A's shares, and A to sell A's shares to B, in exchange for \$100x. Corporation X redeems A's shares for \$100x. Assume that, under applicable tax law, B has a primary and unconditional obligation to purchase A's stock, and therefore the stock redemption results in a constructive distribution to B. Also assume that the special rule of paragraph (c)(1) of this section does not apply. Accordingly, under paragraphs (a)(2) and (b)(2) of this section, A shall be treated as transferring A's stock of Corporation X to B in a transfer to which section 1041 applies (assuming the requirements of section 1041 are otherwise satisfied), B shall be treated as transferring the Corporation X stock B is deemed to have received from A to Corporation X in exchange for \$100x in an exchange to which section 1041 does not apply and sections 302(d) and 301 apply, and B shall be treated as transferring the \$100x to A in a transfer to which section 1041 applies.

Example 2. Assume the same facts as *Example 1*, except that the divorce instrument provides as follows: "A and B agree that the redemption will be treated for federal income tax purposes as a redemption distribution to A." The divorce instrument further provides that it "supersedes all other instruments or agreements concerning the purchase, sale, redemption, or other disposition of the stock that is the subject of the redemption." By virtue of the special rule of paragraph (c)(1) of this section and under paragraphs (a)(1) and (b)(1) of this section, the tax consequences of the redemption shall be determined in accordance with its form as a redemption of A's shares by Corporation X and shall not be treated as resulting in a constructive distribution to B. See section 302.

Example 3. Assume the same facts as *Example 1*, except that the divorce instrument requires A to sell A's shares to Corporation X in exchange for a note. B guarantees Corporation X's payment of the note. Assume that, under applicable tax law, B does not have a primary and unconditional obligation to purchase A's stock, and therefore the stock redemption does not result in a constructive distribution to B. Also assume that the special rule of paragraph (c)(2) of this section does not apply. Accordingly, under paragraphs (a)(1) and (b)(1) of this section, the tax consequences of the redemption shall be determined in accordance with its form as a redemption of A's shares by Corporation X. See section 302.

Example 4. Assume the same facts as *Example 3*, except that the divorce instrument provides as follows: "A and B agree the redemption shall be treated, for federal income tax purposes, as resulting in a constructive distribution to B." The divorce instrument further provides that it "supersedes any other instrument or agreement concerning the purchase, sale, redemption, or other disposition of the stock that is the subject of the redemption." By virtue of the special rule of paragraph (c)(2) of this section, the redemption is treated as resulting in a constructive distribution to B for purposes of paragraph (a)(2) of this section. Accordingly, under paragraphs (a)(2) and (b)(2) of this

section, A shall be treated as transferring A's stock of Corporation X to B in a transfer to which section 1041 applies (assuming the requirements of section 1041 are otherwise satisfied), B shall be treated as transferring the Corporation X stock B is deemed to have received from A to Corporation X in exchange for a note in an exchange to which section 1041 does not apply and sections 302(d) and 301 apply, and B shall be treated as transferring the note to A in a transfer to which section 1041 applies.

(e) *Effective date.* Except as otherwise provided in this paragraph, this section is applicable to redemptions of stock on or after January 13, 2003, except for redemptions of stock that are pursuant to instruments in effect before January 13, 2003. For redemptions of stock before January 13, 2003, and redemptions of stock that are pursuant to instruments in effect before January 13, 2003, see §1.1041-1T(c), A-9. However, these regulations will be applicable to redemptions described in the preceding sentence of this paragraph (e) if the spouses or former spouses execute a written agreement on or after August 3, 2001, that satisfies the requirements of one of the special rules in paragraph (c) of this section with respect to such redemption. A divorce or separation instrument or valid written agreement executed on or after August 3, 2001, and before May 13, 2003, that meets the requirements of the special rule in Regulations Project REG-107151-00 published in 2001-2 C.B. 370 (see §601.601(d)(2) of this chapter) will be treated as also meeting the requirements of the special rule in paragraph (c)(2) of this section.

PART 602—OMB CONTROL
NUMBERS UNDER THE
PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

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1.1041-2 1545-1751

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David A. Mader, Assistant Deputy Commissioner of Internal Revenue.

Approved December 30, 2002.

Pamela F. Olson, Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 10, 2003, 8:45 a.m., and published in the issue of the Federal Register for January 13, 2003, 68 F.R. 1534)

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(p)(2)(B)-1: Disclosure of returns and return information by other agencies.

T.D. 9036

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 301 and 602

Disclosure of Returns and Return Information by Other Agencies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains a final regulation relating to the disclosure of returns and return information by federal, state, and local agencies other than the IRS. The final regulation permits the IRS to authorize agencies with access to returns and return information under section 6103 of the Internal Revenue Code (Code) to redisclose returns and return information, with the approval of the Commissioner of Internal Revenue (Commissioner), to any authorized recipient set forth in section 6103, subject to the same conditions and restric-

tions, and for the same purposes, as if the recipient had received the information from the IRS directly.

DATES: This regulation is effective January 21, 2003.

FOR FURTHER INFORMATION CONTACT: Julie C. Schwartz, 202-622-4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this final regulation has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 4507(d)) under control number 1545-1757. The collection of information in this regulation is in §301.6103(p)(2)(B)-1. This information is required for the Commissioner to authorize the disclosure of returns and return information from agencies with access to returns and return information under section 6103 to other authorized recipients of returns and return information in accordance with section 6103.

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 estimated annual burden per respondent varies from one half-hour to two hours, depending on individual circumstances, with an estimated average of one hour.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

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 26 U.S.C. 6103.

Background

This document contains amendments to 26 CFR parts 301 and 602. On December 13, 2001, a notice of proposed rulemaking (REG-105344-01, 2002-2 I.R.B. 302 [66 FR 64386]) was published in the Federal Register. No comments were received from the public in response to the notice of proposed rulemaking. No public hearing was requested or held. The proposed regulations are adopted by this Treasury decision.

Explanation of Provisions

The final regulation expands the number of agencies that may redisclose returns and return information if authorized by the Commissioner to any federal, state, or local agency that receives such information under section 6103. Similarly, it expands the universe of authorized recipients of returns and return information pursuant to this redisclosure authority to any recipient authorized to receive returns and return information in accordance with section 6103. All redisclosures by agencies pursuant to this regulation will be made subject to the same conditions, restrictions, safeguards, recordkeeping requirements, and civil and criminal penalties that would apply if the disclosure were made by the IRS. Federal, state and local agencies making disclosures of return information under the final regulation will continue to provide to the IRS certain information regarding disclosures made pursuant to this authority, in order for the IRS to fulfill its reporting requirements under section 6103(p).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment