

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

[TD 8936]

RIN 1545-AW17

**Definition of Contribution in Aid of Construction Under Section 118(c)****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations concerning an exclusion from gross income for a contribution in aid of construction under section 118(c) that is treated as a contribution to capital under section 118(a). The final regulations affect a regulated public utility that provides water or sewerage services because a qualifying contribution in aid of construction is treated as a contribution to the capital of the utility and excluded from gross income. The final regulations provide guidance on the definition of a contribution in aid of construction, the adjusted basis of any property acquired with a contribution in aid of construction, the information relating to a contribution in aid of construction required to be furnished by the utility, and the time and manner for providing that information to the IRS.

**DATES:** *Effective Date:* These regulations are effective January 11, 2001.

*Date of Applicability:* For date of applicability of § 1.118-2, see § 1.118-2(f).

**FOR FURTHER INFORMATION CONTACT:** Paul Handleman, (202) 622-3040 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:****Paperwork Reduction Act**

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-1639. Responses to these collections of information are mandatory.

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 estimated annual burden per respondent varies from .5 hour to 5 hours, depending on individual circumstances, with an estimated average of 1 hour.

Comments concerning the accuracy of these burden estimates and suggestions for reducing these burdens should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S:O, 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 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 December 20, 1999, the IRS published proposed regulations (REG-106012-98) in the **Federal Register** (64 FR 71082) inviting comments under section 118(c). A public hearing was held April 27, 2000. Numerous comments have been received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

**Summary of Comments**

Under section 118(a), gross income does not include any contribution to the capital of the taxpayer. Section 118(c)(1) provides that a contribution to the capital of a taxpayer includes any amount of money or other property received from any person (whether or not a shareholder) by a regulated public utility that provides water or sewerage disposal services if the amount is a contribution in aid of construction, satisfies the expenditure rule, and is not included in rate base for ratemaking purposes. Pursuant to the authority granted to the Secretary under section 118(c)(3)(A), the proposed regulations define a *contribution in aid of construction* as any amount of money or other property contributed to a regulated public utility that provides water or sewerage disposal services to the extent that the purpose of the contribution is to provide for the expansion, improvement, or replacement of the utility's water or sewerage disposal facilities.

**Customer Connection Fees**

The proposed regulations define nontaxable contributions in aid of construction to exclude customer connection fees. Customer connection fees are defined in the proposed regulations to include amounts paid for the cost of installing a connection or service line (including the cost of meters

and piping) from the utility's main lines to the lines owned by the customer, unless the connection or service line serves, or is designed to serve, more than one customer. Customer connection fees also are defined in the proposed regulations to include any amounts paid as service charges for starting or stopping services.

Several commentators contend that connection and service lines should not be treated as taxable customer connection fees for a number of reasons. For example, these commentators argue that the omission from the current law of the language included in former section 118(b)(3)(A) that directed the Secretary to define a contribution in aid of construction to exclude amounts paid to connect the customer's line to a main water or sewer line signals congressional intent to include connection and service lines in the definition of a nontaxable contribution in aid of construction. In addition, some of these commentators believe that the inclusion of connection and service lines as taxable customer connection fees is inconsistent with the judicial interpretation of a contribution in aid of construction, which arguably would treat contributions for main lines and connection and service lines as taxable prerequisites for services under the Supreme Court's decision in *United States v. Chicago, Burlington & Quincy R.R.*, 412 U.S. 401 (1973) (1973-2 C.B. 428). Some of these commentators also contend that the exclusion of connection and service lines from the definition of a nontaxable contribution in aid of construction is inconsistent with regulatory accounting treatment, which does not distinguish between main lines and connection and service lines for purposes of classifying property or for purposes of ratemaking. Finally, a few of these commentators point out that the inclusion of connection and service lines as taxable customer connection fees will result in customers being required to gross-up their contributions of connection and service lines for taxes, increasing the cost of housing and development and creating a competitive disadvantage for investor-owned utilities.

The IRS and Treasury Department do not agree with the commentators' position with respect to connection and service lines. As explained in the preamble to the proposed regulations, the inclusion of connection and service lines in the definition of taxable customer connection fees is consistent with the legislative history explanation that section 118(c) was intended to restore the contribution in aid of construction provision of former section

118(b) that was repealed by The Tax Reform Act of 1986 for regulated public utilities that provide water or sewerage disposal services. H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 316 (1996) (1996-3 C.B. 741, 1056). While the language regarding the definition of a contribution in aid of construction did change from the language in former section 118(b), Congress did not explicitly include connection and service lines in the definition of a contribution in aid of construction but instead directed the Secretary to define a contribution in aid of construction, presumably aware of the IRS' and Treasury Department's position that connection and service lines are taxable customer connection fees based on Rev. Rul. 75-557 (1975-2 C.B. 33), and the proposed regulations under former section 118(b) (43 FR 22997 (May 30, 1978)). Moreover, the IRS and Treasury Department continue to believe that the exclusion of connection and service lines from a nontaxable contribution in aid of construction is more consistent with the judicial and regulatory interpretation of a contribution in aid of construction and with the Supreme Court's directive that exclusions be narrowly construed. See, for example, *Edwards v. Cuba R.R.*, 268 U.S. 628 (1925) (IV-2 C.B. 122); *Detroit Edison Co. v. Commissioner*, 319 U.S. 98 (1943) (1943 C.B. 1019); *Chicago, Burlington & Quincy R.R.*, 412 U.S. at 401; *Florida Progress Corp. v. United States*, No. 93-246-CIV-T-25A (M.D. Fla. July 2, 1998), *appeal docketed*, No. 99-15389-FF (11th Cir. Dec. 29, 1999); *Commissioner v. Schleier*, 515 U.S. 323, 328 (1995); and Rev. Rul. 75-557. As explained by the court in *Teco Energy, Inc. v. United States*, No. 98-430-Civ-J-TJC (M.D. Fla. Oct. 21, 1999), "former [section] 118(b) codifies the principles of *Edwards* that payments made by a government or other group to a utility to encourage the extension of facilities into new areas benefiting a large number of people are given tax free status, while also affirming the reasoning of *Detroit Edison* Revenue Ruling 75-557, that payments made by an individual or business entity to a utility as a prerequisite to receiving water or sewage services would be treated as taxable income to the utility." Further, the IRS and Treasury Department believe that the definition of a contribution in aid of construction used for regulatory accounting purposes should not control for tax purposes. See, for example, *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 541-45 (1979) (1979-1 C.B. 167). Accordingly, the final regulations retain the exclusion

of connection and service lines from the definition of a nontaxable contribution in aid of construction.

Some commentators state that, before the proposed regulations were published, some utilities took the position that payments for connection and service lines were not taxable and did not charge their contributors a sufficient amount to cover their tax liabilities. The IRS and Treasury Department understand that there was uncertainty before the proposed regulations were published and that some utilities may have reasonably interpreted section 118(c)(3)(A) to mean that connection and service lines should not be treated as taxable. It is clear that these final regulations apply to money and other property received on or after January 11, 2001 and do not apply to transactions entered into prior to that date. In addition, the IRS will take into account all the facts and circumstances in applying section 118(c) to such transactions.

Commentators suggest that customer connection fees relating to services provided to public authorities, such as schools, hospitals, public libraries, and governmental entities, should be included in the definition of nontaxable contributions in aid of construction because these services provide a broad public benefit. In addition, commentators recommend that customer connection fees relating to fire protection services should qualify as nontaxable contributions in aid of construction because a utility receives no revenue for public fire protection services and only a nominal standby fee for private fire protection services. The IRS and Treasury Department believe that, regardless of whether the activities of public authorities provide a public benefit, connection and service lines that serve these customers should be treated in the same manner as connection or service lines to any paying customer—as a prerequisite for services. Consequently, the final regulations continue to treat amounts paid for connection and service lines with respect to public authorities as customer connection fees. However, the IRS and the Treasury Department agree with commentators that amounts paid with respect to fire protection services should not be considered customer connection fees.

Several commentators suggest that connection and service lines that serve more than one user, such as lines for apartment houses, condominium projects, shopping malls, and office buildings, should be considered to serve more than one customer and, thus, be excluded from taxable customer

connection fees, regardless of whether the utility treats the facility as one customer or many. The final regulations do not adopt this suggestion because whether connection or service lines are designed to serve more than one customer does not depend on the number of users but upon the number of customers. Thus, for example, if a water or sewerage disposal utility treats an apartment or office building as one utility customer, then the cost of connecting the utility's main lines to the connection or service lines serving that single customer is a taxable customer connection fee.

#### *Binding Agreement Rule*

The proposed regulations provide that if a water or sewerage disposal facility is placed in service by the utility before an amount is contributed to the utility, the contribution is not a nontaxable contribution in aid of construction unless, at the time the facility is placed in service by the utility, there is an agreement, binding under local law between the prospective contributor and the utility, that the utility is to receive the amount as reimbursement for the cost of acquiring or constructing the facility.

Commentators suggest that the binding agreement rule should be expanded to include enforceable public utility commission orders and tariffs. The final regulations adopt this suggestion by treating an order or a tariff, issued or approved by the applicable public utility commission, that requires a current or prospective customer to reimburse the utility for the cost of acquiring or constructing the facility as a binding agreement. Because public utility commission orders or tariffs may be issued or approved before or after the facility is placed in service, the final regulations also extend the time for entering into a binding agreement or the issuance or approval of an order or a tariff to no later than 8½ months after the close of the taxable year (the usual due date with extensions for a taxpayer's return) in which the facility is placed in service.

One commentator suggests adding an example demonstrating that payments made pursuant to a binding agreement qualify as a contribution in aid of construction under section 118(c). The final regulations adopt this suggestion.

#### *Basis Rules*

The proposed regulations provide that the basis of a water or sewerage facility acquired or constructed with a contribution under a binding agreement must be reduced by the amount of the contribution at the time the facility is

placed in service. Several commentators suggest that if the receipt of all of the expected contributions under the agreement occurs more than one or two years after a facility is placed in service, the utility should be permitted to claim the full cost of the facility as basis for depreciation purposes, subject to adjustment as the contributions are received. The final regulations do not adopt this comment because section 118(c)(4) disallows any depreciation deductions for a water or sewerage disposal facility that is fully paid with a nontaxable contribution in aid of construction under section 118(c). This result is consistent with similar rules that either exclude expected contributions from basis or deny a deduction to the extent the taxpayer has a right to, or reasonable prospect of, reimbursement. See, for example, § 1.110-1(b)(4)(ii)(B); § 1.165-1(d)(2)(i); and Rev. Rul. 79-263 (1979-2 C.B. 82).

The proposed regulations provide that, if a contribution in aid of construction treated as a contribution to the capital of the taxpayer is repaid to the contributor, either in whole or in part, then the repayment amount is a capital expenditure in the taxable year in which it is paid or incurred, resulting in an increase in the property's adjusted basis in such year. A couple of commentators suggest that the repayment should be depreciated over the remaining life of the property. The final regulations adopt this suggestion.

#### Reporting Requirement

The proposed regulations provide that a taxpayer treating a contribution in aid of construction as a contribution to capital must file a statement with its tax returns to report the amount of the contribution in aid of construction the taxpayer: (1) Expended during the taxable year for property described in section 118(c)(2)(A) (qualified property); (2) does not intend to expend for qualified property; and (3) failed to expend for qualified property. Several commentators express concern that the reporting requirement in the proposed regulations exceeds the intent of the statute because section 118(c)(2)(C) only requires the maintenance of adequate records. However, section 118(d)(1) provides that if the taxpayer for any taxable year treats an amount as a contribution to the capital of the taxpayer described in section 118(c), then the statutory period for the assessment of any deficiency attributable to any part of the amount does not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such

manner as the Secretary may prescribe) of the amount of the expenditure referred to in section 118(c)(2)(A), of the taxpayer's intention not to make the expenditures referred to in section 118(c)(2)(A), or of a failure to make the expenditure within the period described in section 118(c)(2)(B). Thus, the regulations do not impose an additional reporting requirement but merely provide the time and manner in which taxpayers must notify the Secretary under section 118(d)(1) of amounts treated as contributions in aid of construction.

#### Collection of Information under Paperwork Reduction Act

Two comments were sent to OMB on the collection of information contained in the proposed regulations, with copies of the comments sent to the IRS Reports Clearance Officer. The commentators estimate that complying with the recordkeeping requirements of section 118(c)(2)(C) involves more hours and that the number of respondents is greater than estimated. The collection of information burden under the proposed regulations is based only upon the time for notifying the IRS of the required information under section 118(d)(1) and is not required to include the time for maintaining accurate books and records. Thus, the individual time to comply with the collection of information burden was not increased to reflect these commentators concerns. However, the estimated number of annual respondents has been increased to 300 and the estimated total annual reporting burden has been increased to 300 hours.

#### 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 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. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that any burden on taxpayers is minimal. Accordingly, 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 Paul F. Handleman, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

#### List of Subjects

##### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

##### 26 CFR Part 602

Reporting and recordkeeping requirements.

#### 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 is amended by adding an entry in numerical order to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*  
Section 1.118-2 also issued under 26 U.S.C. 118(c)(3)(A); \* \* \*

**Par. 2.** Section 1.118-2 is added to read as follows:

##### § 1.118-2 Contribution in aid of construction.

(a) *Special rule for water and sewerage disposal utilities—(1) In general.* For purposes of section 118, the term *contribution to the capital of the taxpayer* includes any amount of money or other property received from any person (whether or not a shareholder) by a regulated public utility that provides water or sewerage disposal services if—

(i) The amount is a contribution in aid of construction under paragraph (b) of this section;

(ii) In the case of a contribution of property other than water or sewerage disposal facilities, the amount satisfies the expenditure rule under paragraph (c) of this section; and

(iii) The amount (or any property acquired or constructed with the amount) is not included in the taxpayer's rate base for ratemaking purposes.

(2) *Definitions—(i) Regulated public utility* has the meaning given such term by section 7701(a)(33), except that such term does not include any utility which is not required to provide water or sewerage disposal services to members of the general public in its service area.

(ii) *Water or sewerage disposal facility* is defined as tangible property described in section 1231(b) that is used predominately (80% or more) in the trade or business of furnishing water or sewerage disposal services.

(b) *Contribution in aid of construction*—(1) *In general.* For purposes of section 118(c) and this section, the term *contribution in aid of construction* means any amount of money or other property contributed to a regulated public utility that provides water or sewerage disposal services to the extent that the purpose of the contribution is to provide for the expansion, improvement, or replacement of the utility's water or sewerage disposal facilities.

(2) *Advances.* A contribution in aid of construction may include an amount of money or other property contributed to a regulated public utility for a water or sewerage disposal facility subject to a contingent obligation to repay the amount, in whole or in part, to the contributor (commonly referred to as an advance). For example, an amount received by a utility from a developer to construct a water facility pursuant to an agreement under which the utility will pay the developer a percentage of the receipts from the facility over a fixed period may constitute a contribution in aid of construction. Whether an advance is a contribution or a loan is determined under general principles of federal tax law based on all the facts and circumstances. For the treatment of any amount of a contribution in aid of construction that is repaid by the utility to the contributor, see paragraphs (c)(2)(ii) and (d)(2) of this section.

(3) *Customer connection fee*—(i) *In general.* Except as provided in paragraph (b)(3)(ii) of this section, a customer connection fee is not a contribution in aid of construction under this paragraph (b) and generally is includible in income. The term *customer connection fee* includes any amount of money or other property transferred to the utility representing the cost of installing a connection or service line (including the cost of meters and piping) from the utility's main water or sewer lines to the line owned by the customer or potential customer. A customer connection fee also includes any amount paid as a service charge for starting or stopping service.

(ii) *Exceptions*—(A) *Multiple customers.* Money or other property contributed for a connection or service line from the utility's main line to the customer's or the potential customer's line is not a customer connection fee if the connection or service line serves, or is designed to serve, more than one

customer. For example, a contribution for a split service line that is designed to serve two customers is not a customer connection fee. On the other hand, if a water or sewerage disposal utility treats an apartment or office building as one utility customer, then the cost of installing a connection or service line from the utility's main water or sewer lines serving that single customer is a customer connection fee.

(B) *Fire protection services.* Money or other property contributed for public and private fire protection services is not a customer connection fee.

(4) *Reimbursement for a facility previously placed in service*—(i) *In general.* If a water or sewerage disposal facility is placed in service by the utility before an amount is contributed to the utility, the contribution is not a contribution in aid of construction under this paragraph (b) with respect to the cost of the facility unless, no later than 8½ months after the close of the taxable year in which the facility was placed in service, there is an agreement, binding under local law, that the utility is to receive the amount as reimbursement for the cost of acquiring or constructing the facility. An order or tariff, binding under local law, that is issued or approved by the applicable public utility commission requiring current or prospective utility customers to reimburse the utility for the cost of acquiring or constructing the facility, is a binding agreement for purposes of the preceding sentence. If an agreement exists, the basis of the facility must be reduced by the amount of the expected contributions. Appropriate adjustments must be made if actual contributions differ from expected contributions.

(ii) *Example.* The application of paragraph (b)(4)(i) of this section is illustrated by the following example:

*Example.* M, a calendar year regulated public utility that provides water services, spent \$1,000,000 for the construction of a water facility that can serve 200 customers. M placed the facility in service in 2000. In June 2001, the public utility commission that regulates M approves a tariff requiring new customers to reimburse M for the cost of constructing the facility by paying a service availability charge of \$5,000 per lot. Pursuant to the tariff, M expects to receive reimbursements for the cost of the facility of \$100,000 per year for the years 2001 through 2010. The reimbursements are contributions in aid of construction under paragraph (b) of this section because no later than 8½ months after the close of the taxable year in which the facility was placed in service there was a tariff, binding under local law, approved by the public utility commission requiring new customers to reimburse the utility for the cost of constructing the facility. The basis of the \$1,000,000 facility is zero because the

expected contributions equal the cost of the facility.

(5) *Classification by ratemaking authority.* The fact that the applicable ratemaking authority classifies any money or other property received by a utility as a contribution in aid of construction is not conclusive as to its treatment under this paragraph (b).

(c) *Expenditure rule*—(1) *In general.* An amount satisfies the expenditure rule of section 118(c)(2) if the amount is expended for the acquisition or construction of property described in section 118(c)(2)(A), the amount is paid or incurred before the end of the second taxable year after the taxable year in which the amount was received as required by section 118(c)(2)(B), and accurate records are kept of contributions and expenditures as provided in section 118(c)(2)(C).

(2) *Excess amount*—(i) *Includible in the utility's income.* An amount received by a utility as a contribution in aid of construction that is not expended for the acquisition or construction of water or sewerage disposal facilities as required by paragraph (c)(1) of this section (the excess amount) is not a contribution to the capital of the taxpayer under paragraph (a) of this section. Except as provided in paragraph (c)(2)(ii) of this section, such excess amount is includible in the utility's income in the taxable year in which the amount was received.

(ii) *Repayment of excess amount.* If the excess amount described in paragraph (c)(2)(i) of this section is repaid, in whole or in part, either—

(A) Before the end of the time period described in paragraph (c)(1) of this section, the repayment amount is not includible in the utility's income; or

(B) After the end of the time period described in paragraph (c)(1) of this section, the repayment amount may be deducted by the utility in the taxable year in which it is paid or incurred to the extent such amount was included in income.

(3) *Example.* The application of this paragraph (c) is illustrated by the following example:

*Example.* M, a calendar year regulated public utility that provides water services, received a \$1,000,000 contribution in aid of construction in 2000 for the purpose of constructing a water facility. To the extent that the \$1,000,000 exceeded the actual cost of the facility, the contribution was subject to being returned. In 2001, M built the facility at a cost of \$700,000 and returned \$200,000 to the contributor. As of the end of 2002, M had not returned the remaining \$100,000. Assuming accurate records are kept, the requirement under section 118(c)(2) is satisfied for \$700,000 of the contribution.

Because \$200,000 of the contribution was returned within the time period during which qualifying expenditures could be made, this amount is not includible in M's income. However, the remaining \$100,000 is includible in M's income for its 2000 taxable year (the taxable year in which the amount was received) because the amount was neither spent nor repaid during the prescribed time period. To the extent M repays the remaining \$100,000 after year 2002, M would be entitled to a deduction in the year such repayment is paid or incurred.

(d) *Adjusted basis*—(1) *Exclusion from basis*. Except for a repayment described in paragraph (d)(2) of this section, to the extent that a water or sewerage disposal facility is acquired or constructed with an amount received as a contribution to the capital of the taxpayer under paragraph (a) of this section, the basis of the facility is reduced by the amount of the contribution. To the extent the water or sewerage disposal facility is acquired as a contribution to the capital of the taxpayer under paragraph (a) of this section, the basis of the contributed facility is zero.

(2) *Repayment of contribution*. If a contribution to the capital of the taxpayer under paragraph (a) of this section is repaid to the contributor, either in whole or in part, then the repayment amount is a capital expenditure in the taxable year in which it is paid or incurred, resulting in an increase in the property's adjusted basis in such year. Capital expenditures allocated to depreciable property under paragraph (d)(3) of this section may be depreciated over the remaining recovery period for that property.

(3) *Allocation of contributions*. An amount treated as a capital expenditure under this paragraph (d) is to be allocated proportionately to the adjusted basis of each property acquired or constructed with the contribution based on the relative cost of such property.

(4) *Example*. The application of this paragraph (d) is illustrated by the following example:

*Example*. A, a calendar year regulated public utility that provides water services, received a \$1,000,000 contribution in aid of construction in 2000 as an advance from B, a developer, for the purpose of constructing a water facility. To the extent that the \$1,000,000 exceeds the actual cost of the facility, the contribution is subject to being returned. Under the terms of the advance, A agrees to pay to B a percentage of the receipts from the facility over a fixed period, but limited to the cost of the facility. In 2001, A builds the facility at a cost of \$700,000 and returns \$300,000 to B. In 2002, A pays \$20,000 to B out of the receipts from the facility. Assuming accurate records are kept, the \$700,000 advance is a contribution to the capital of A under paragraph (a) of this

section and is excludable from A's income. The basis of the \$700,000 facility constructed with this contribution to capital is zero. The \$300,000 excess amount is not a contribution to the capital of A under paragraph (a) of this section because it does not meet the expenditure rule described in paragraph (c)(1) of this section. However, this excess amount is not includible in A's income pursuant to paragraph (c)(2)(ii) of this section since the amount is repaid to B within the required time period. The repayment of the \$300,000 excess amount to B in 2001 is not treated as a capital expenditure by A. The \$20,000 payment to B in 2002 is treated as a capital expenditure by A in 2002 resulting in an increase in the adjusted basis of the water facility from zero to \$20,000.

(e) *Statute of limitations*—(1) *Extension of statute of limitations*. Under section 118(d)(1), the statutory period for assessment of any deficiency attributable to a contribution to capital under paragraph (a) of this section does not expire before the expiration of 3 years after the date the taxpayer notifies the Secretary in the time and manner prescribed in paragraph (e)(2) of this section.

(2) *Time and manner of notification*. Notification is made by attaching a statement to the taxpayer's federal income tax return for the taxable year in which any of the reportable items in paragraphs (e)(2)(i) through (iii) of this section occur. The statement must contain the taxpayer's name, address, employer identification number, taxable year, and the following information with respect to contributions of property other than water or sewerage disposal facilities that are subject to the expenditure rule described in paragraph (c) of this section—

(i) The amount of contributions in aid of construction expended during the taxable year for property described in section 118(c)(2)(A) (qualified property) as required under paragraph (c)(1) of this section, identified by taxable year in which the contributions were received;

(ii) The amount of contributions in aid of construction that the taxpayer does not intend to expend for qualified property as required under paragraph (c)(1) of this section, identified by taxable year in which the contributions were received; and

(iii) The amount of contributions in aid of construction that the taxpayer failed to expend for qualified property as required under paragraph (c)(1) of this section, identified by taxable year in which the contributions were received.

(f) *Effective date*. This section is applicable for any money or other property received by a regulated public utility that provides water or sewerage

disposal services on or after January 11, 2001.

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

**Par. 3.** The authority citation for part 602 continues to read as follows:

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

**Par. 4.** In § 602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:

**§ 602.101 OMB Control numbers.**

\* \* \* \* \*  
(b) \* \* \*

CFR part or section identified and described	Current OMB control No.
* * * * *	* * * * *
1.118-2 .....	1545-1639
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**Robert E. Wenzel,**  
*Deputy Commissioner of Internal Revenue.*

Approved: December 20, 2000.

**Jonathan Talisman,**  
*Acting Assistant Secretary of the Treasury.*  
[FR Doc. 01-487 Filed 1-10-01; 8:45 am]

**BILLING CODE 4830-01-P**

**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Parts 1 and 7**

[TD 8937]

**RIN 1545-AY53**

**Stock Transfer Rules: Transition Rules**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations and removal of temporary regulations.

**SUMMARY:** This document contains final regulations addressing distributions with respect to, or a disposition of, certain stock that was subject to prior temporary regulations under section 367(b). Section 367(b) addresses the application of nonrecognition exchange provisions in Subchapter C of the Internal Revenue Code to transactions that involve one or more foreign corporations.

**DATES: Effective Date.** These regulations are effective as of January 11, 2001.

**Applicability Dates.** These regulations apply to distributions or dispositions that occur on or after January 11, 2001.