routine amendments are necessary to keep them operationally current. It, therefore—(1) is not a ''significant regulatory action'' under Executive Order 12866; (2) is not a ''significant rule'' under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule, when promulgated, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

List of Subjects in 14 CFR Part 71

Airspace, Incorporation by reference, Navigation (air).

The Proposed Amendment

In consideration of the foregoing, the Federal Aviation Administration proposes to amend 14 CFR part 71 as follows:

PART 71—DESIGNATION OF CLASS A, CLASS B, CLASS C, CLASS D, AND CLASS E AIRSPACE AREAS; AIRWAYS; ROUTES; AND REPORTING POINTS

1. The authority citation for 14 CFR part 71 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40103, 40113, 40120; E.O. 10854, 24 FR 9565, 3 CFR, 1959–1963 Comp., p. 389.

§ 71.1 [Amended]

2. The incorporation by reference in 14 CFR 71.1 of Federal Aviation Administration Order 7400.9F, *Airspace Designations and Reporting Points,* dated September 10, 1998, and effective September 16, 1998, is to be amended as follows:

Paragraph 6005 Class E airspace areas extending upward from 700 feet or more above the surface of the earth.

* * * * *

AAL AK E5 Port Heiden, AK

Port Heiden Airport, AK
(Lat. 56°57′32″ N., long. 158°37′57″ W.)
Port Heiden NDB
(Lat. 56°57′15″ N., long. 158°38′56″ W.)
Turnbull VOR/DME
(Lat. 56°57′04″ N., long. 158°38′27″ W.)

That airspace extending upward from 700 feet above the surface within a 6.9-mile radius of the Port Heiden Airport, and within 4 miles north and 8 miles south of the Port Heiden NDB 248° bearing extending from the NDB to 20 miles west, and within 8 miles west and 4 miles east of the Port Heiden NDB 339° bearing extending from the NDB to 20 miles northwest; and that airspace extending upward from 1200 feet above the surface within 13 miles west and 4 miles east of the Port Heiden NDB 339° bearing extending from the NDB to 25 miles north, and within 17 miles of the Turnbull VOR/DME extending clockwise from the 213° radial to the 074° radial, and within 9 miles north of the Port Heiden NDB 248° bearing extending from the NDB to 24 miles west.

* * * * *

Issued in Anchorage, AK, on January 22, 1999.

Willis C. Nelson,

Manager, Air Traffic Division, Alaskan Region.

[FR Doc. 99–2336 Filed 1–29–99; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–209619–93]

RIN 1545–AR82

Escrow Funds and Other Similar Funds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the designation of the person required to report the income earned on qualified settlement funds and certain other funds, trusts, and escrow accounts, and other related rules. The proposed regulations would affect qualified settlement funds, qualified escrow accounts and qualified trusts established in connection with deferred like-kind exchanges, escrow accounts established in connection with sales of property, disputed ownership funds, and parties to these escrow accounts, trusts, and funds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by May 3, 1999. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for May 12, 1999, at 10 a.m., must be received by April 21, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–209619–93), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–209619–93), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the INTERNET by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS INTERNET site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Michael L. Gompertz of the Office of Assistant Chief Counsel (Income Tax & Accounting), (202) 622–4910; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Michael Slaughter, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent 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, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by April 2, 1999. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in this proposed regulation are in §§ 1.468B–

1(k)(2), 1.468B–1(k)(3)(iv), 1.468B–6(e)(1), 1.468B–6(f), 1.468B–7(d), 1.468B–8(f), 1.468B–8(g)(1), 1.468B-9(c)(1), and 1.468B–9(f)(3).

The collections of information in §§ 1.468B–1(k)(3)(iv), 1.468B–6(e)(1), 1.468B–7(d), 1.468B–8(g)(1), and 1.468B–9(c)(1) are satisfied by including the required information on Forms 1099, 1041, 1120, or 1120–SF. The burden for these requirements is reflected in the burden estimates for these forms.

The other collections of information in this proposed regulation (in §§ 1.468B–1(k)(2), 1.468B–6(f), 1.468B–8(f), and 1.468B–9(f)(3)) are discussed below.

The collection of information in § 1.468B–1(k)(2) is an election statement attached to a tax return filed for a qualified settlement fund (QSF). The statement notifies the IRS that the transferor to the QSF has elected grantor trust treatment for the QSF. This collection is required to obtain a benefit.

The collections of information in §§ 1.468B–6(f) and 1.468B–8(f) are statements that third parties must provide to an escrow holder, trustee, or administrator to enable the escrow holder, trustee, or administrator to properly report the income of an escrow account or trust on Form 1099. These collections are mandatory.

The collection of information in § 1.468B–9(f)(3) is a statement that a transferor must provide with respect to the transfer of cash or property to a disputed ownership fund. This collection is mandatory.

The likely respondents are individuals, business or other for-profit institutions, small businesses or organizations, nonprofit institutions, and government entities.

Estimated total annual reporting burden: *4,650* hours.

Estimated average annual burden per respondent: *.5* hours.

Estimated number of respondents: *9,300*.

Estimated annual frequency of responses: on occasion.

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.

Books and 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.

Background

This notice contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 468B of the Internal Revenue Code. Section 468B was added to the Code by section 1807(a)(7)(A) of the Tax Reform Act of 1986 (Public Law 99–514, 100 Stat. 2814) and was amended by section 1018(f) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100–647, 102 Stat. 3582). Section 468B(g) provides that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. Section 468B(g) further provides that the Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

On December 23, 1992, final regulations (TD 8459) under section 468B(g) were published in the **Federal Register** (57 FR 60983). The regulations provide guidance concerning qualified settlement funds, but do not address other types of funds, escrow accounts, or trusts subject to current taxation under section 468B(g).

Section 1.468B–1(c) defines a qualified settlement fund (QSF) as a fund, account, or trust meeting three requirements. A QSF is a separate taxpayer subject to tax on its modified gross income. QSF classification is not elective. The preamble to the QSF regulations (see 1993–1 C.B. 69) states that the IRS and the Treasury Department rejected an elective approach because it would result in inconsistent tax treatment for similar funds, claimants, or transferors, and accompanying complexity.

The preamble to the QSF regulations also states (see 1993–1 C.B. 73) that future regulations will address the tax treatment of funds, accounts, or trusts other than QSFs, specifically, escrow accounts used in the sale of property and section 1031 qualified escrow accounts.

Section 1031(a)(3) was added to the Internal Revenue Code by section 77 of the Tax Reform Act of 1984 (Public Law 98–369, 98 Stat. 595). On May 1, 1991, final regulations (TD 8346) under section 1031(a)(3) were published in the **Federal Register** (56 FR 19933). These regulations were amended by final regulations (TD 8535) published in the **Federal Register** for April 20, 1994 (59 FR 18747). The regulations provide four safe harbors, the use of any of which will result in a determination that the taxpayer (i.e., the party transferring the property in the exchange) is not in actual or constructive receipt of money or other property for purposes of section 1031. In particular, the regulations provide that the taxpayer is not in actual or constructive receipt of money or other property held in a *qualified escrow account* or *qualified trust*. Section 1.1031(k)–1(g)(3) defines *qualified escrow account* and *qualified trust*.

The regulations under section 1031(a)(3) do not address the taxation of income earned on a qualified escrow or qualified trust. The preamble to these regulations (see 1991–1 C.B. 154) states that this issue will be addressed in future regulations.

Explanation of Provisions

1. Election To Treat a QSF as a Grantor Trust Under § 1.468B–1(k) of the Proposed Regulations

The proposed regulations provide that if there is only one transferor to a QSF, the transferor is allowed to make an election that results in the QSF being treated as a grantor trust all of which is treated as owned by the transferor. In general, the election is made on a statement attached to the first Form 1041 filed on behalf of the QSF. The transferor may make a grantor trust election whether or not the requirements are otherwise satisfied for classification of the QSF as a grantor trust.

In general, grantor trust treatment for a QSF is available under the proposed regulations only if the QSF is established after the date final regulations are published in the **Federal Register**. However, the proposed regulations provide a narrow exception applicable to any QSF established by the U.S. government on or before the date final regulations are published if the QSF would otherwise have been classified as a grantor trust in the absence of the QSF regulations (see Rev. Rul. 77–230 (1977–2 C.B. 214)). Under the exception, such a QSF will be automatically treated as a grantor trust for all taxable years and a grantor trust election is thus unnecessary. If a QSF is established after the date final regulations are published, a grantor trust election will be required in order for the QSF to be treated as a grantor trust. This rule applies whether or not the U.S. government is the grantor.

2. Section 1031 Qualified Escrow Accounts and Qualified Trusts Under § 1.468B–6 of the Proposed Regulations

In general, the proposed regulations treat the assets of a qualified escrow account or qualified trust established in connection with a deferred exchange under section 1031(a)(3) as owned by the taxpayer, i.e., the party that transfers the relinquished property. Thus, the taxpayer is taxable on the income earned on these assets. However, if the transferee or the qualified intermediary has all the beneficial use and enjoyment of the assets of a qualified escrow account or qualified trust, then the assets of the escrow account or trust are treated as owned by the transferee or qualified intermediary, and the income earned on the assets is taxable to the transferee or qualified intermediary.

Further, the proposed regulations require the escrow holder of a qualified escrow account or trustee of a qualified trust to report the income of the escrow account or trust on Forms 1099 to the extent the information reporting provisions of the Code otherwise require the filing of Forms 1099. In general, the taxpayer is treated as the payee of the income of the escrow account or trust unless the parties to the transaction provide a statement to the escrow holder or trustee indicating that the transferee or qualified intermediary is the payee. Such a statement must be provided if the transferee or qualified intermediary has all the beneficial use and enjoyment of the assets of the escrow account or trust.

The proposed regulations provide that the escrow holder or trustee is not liable for penalties under sections 6721 and 6722 if the escrow holder or trustee relies on an incorrect statement provided to the escrow holder or trustee (see above) or relies on the parties' failure to provide such a statement.

The proposed regulations also provide that if the transferee or the qualified intermediary has all the beneficial use and enjoyment of the assets of a qualified escrow account or trust, the deferred exchange may involve a below-market loan of these assets from the taxpayer to the transferee or qualified intermediary subject to the provisions of section 7872.

3. Pre-closing Escrows Under § 1.468B–7 of the Proposed Regulations

A pre-closing escrow is an escrow account, trust, or fund that satisfies five requirements. First, it must be established in connection with a sale or exchange of real or personal property. Second, it must be funded with a down payment, earnest money, or similar payment prior to the sale or exchange of the property (as determined for federal income tax purposes). Third, its assets must be used to secure the purchaser's obligation to pay the purchase price (in the case of an exchange of property, the term *purchaser* means the transferee of the property and the term *purchase price* means the required consideration for the property). Fourth, its assets (including income earned thereon) must be paid to the purchaser or otherwise used for the purchaser's benefit, for example, as a credit against the purchase price. Fifth, it must not be a qualified escrow or qualified trust established in connection with a deferred section 1031 exchange.

The proposed regulations treat the assets of a pre-closing escrow as owned by the purchaser for federal income tax purposes. Thus, the income earned on the assets is taxable to the purchaser. The escrow holder, trustee, or other person responsible for administering a pre-closing escrow must report the income of the escrow on Forms 1099 to the extent the information reporting provisions of the Code otherwise require the filing of Forms 1099.

4. Contingent At-closing Escrows Under § 1.468B–8 of the Proposed Regulations

The proposed regulations provide rules for taxing the income of a contingent at-closing escrow, which is an escrow account, trust, or fund satisfying three requirements. First, a contingent at-closing escrow must be established in connection with the sale or exchange of real or personal property used in a trade or business or held for investment (other than an exchange to which section 354, 355, or 356 applies). Second, the assets of the escrow must be distributable to the purchaser or seller based on bona fide contingencies that will be resolved after the sale or exchange (as determined for federal income tax purposes). (If a contingent at-closing escrow is established in connection with an exchange of property, rather than a sale, the term *purchaser* refers to the transferee of the property and the term *seller* refers to the transferor of the property.) Thus, for example, the agreement between the parties may provide that all or a portion of the assets of the escrow are distributable to the purchaser if specified liabilities associated with the property arise within a specified period of time after closing or if certain earnings targets are not met by a specified date. Third, the escrow must not be a qualified escrow account or qualified trust established in connection with a deferred section 1031 exchange.

Prior to the date (called the determination date) on which the specified events occur or fail to occur, thereby fixing the amounts payable from the escrow to the purchaser and seller, the proposed regulations provide that the assets of the escrow are treated as owned by the purchaser, and the income earned on the assets is thus taxable to the purchaser.

Beginning on the determination date, the proposed regulations provide that the purchaser and the seller are taxable on the income of the escrow corresponding to their respective ownership interests in each asset of the escrow. Further, the proposed regulations require the purchaser and seller to provide the escrow holder, trustee, or other administrator of the escrow with a statement within 30 days of the determination date indicating what these ownership interests are. Also, the escrow holder, trustee, or other administrator is required to prepare Forms 1099 to report the income of a contingent at-closing escrow to the extent the information reporting provisions of the Code otherwise require the filing of Forms 1099.

In preparing the Forms 1099, the escrow holder, trustee, or other administrator may rely on the statement (discussed above) provided to the administrator within 30 days of the determination date. Also, if the statement is not provided, the escrow holder, trustee, or other administrator may rely on the parties' failure to provide a statement and continue to treat the purchaser as the owner. The administrator's ability to rely on a statement, or its absence, protects the administrator from liability for penalties under sections 6721 and 6722.

5. Disputed Ownership Funds Under § 1.468B–9 of the Proposed Regulations

A disputed ownership fund (DOF) is an escrow account, trust, or fund other than a QSF that satisfies three requirements. First, a DOF must be established to hold money or property subject to conflicting claims of ownership. Second, a DOF must be subject to the continuing jurisdiction of a court of law or equity. Third, money or property cannot be paid or distributed from a DOF to a claimant without court approval. An interpleader fund may qualify as a DOF.

In general, a DOF is taxed under the proposed regulations as if it were a qualified settlement fund if all the DOF's assets are passive investment assets, for example, cash or cash equivalents, stock, and debt obligations. However, if the DOF holds assets other than passive investment assets (for example, real estate or business property the ownership of which is in dispute), the DOF is taxed as if it were a C corporation. The claimants to the fund may, however, submit a letter ruling request proposing an alternative method of taxation if they believe that there is a more appropriate method of taxing a DOF than under the rules stated above.

In addition to providing rules for the taxation of the income of a DOF, the proposed regulations also provide rules concerning the transfer of property to and from a DOF. In particular, a transfer of property to a DOF is not a sale or other disposition by the transferor under section 1001(a) if the transferor claims ownership of the transferred property. Also, a DOF is not allowed a deduction for a distribution of disputed property to a claimant and the distribution is not a taxable event to the DOF.

6. Request for Comments

Comments are requested on the appropriate tax treatment of a fund, account, or trust that meets the requirements for more than one type of entity subject to the proposed regulations. Comments are also requested on the appropriate tax treatment of a fund, account, or trust that changes over time so that a different portion of the proposed regulations would apply to it. For example, an escrow initially may meet the requirements for a contingent at-closing escrow, but may subsequently satisfy the requirements for a DOF. This could occur if a dispute were to arise between the purchaser and the seller concerning their respective interests in the escrow after the determination date and the administrator of the DOF files an interpleader action to resolve the dispute.

Comments are also requested concerning the appropriate tax treatment of a contingent-at-closing escrow if multiple contingencies are specified in the agreement between the purchaser and the seller. The proposed regulations provide that (1) the income of a contingent at-closing escrow is taxable entirely to the purchaser prior to the determination date, and (2) the determination date is the date on which (or by which) the last of the contingent events has either occurred or failed to occur. Therefore, if multiple contingencies are provided for in the agreement between the parties and some, but not all, of the contingencies have been resolved, the proposed regulations provide that the income of the escrow is taxable entirely to the purchaser (because the determination date has not yet occurred) regardless of the effect of the contingencies that have been resolved. The purchaser is thus taxed on all the income earned on the escrow even though it may be known (based on the resolution of one or more contingencies) that a fixed portion of the escrowed assets will be distributed to the seller. The proposed rule is simple and easy to administer because it treats the escrow in a unitary manner and avoids the need for multiple determination dates. Arguably, however, a more complex approach should be adopted involving a separate determination date for each contingency. Under the more complex approach, as each contingency is resolved, a new determination would be made concerning the taxation of the fund's income. The income earned on the fund's assets would be taxable to the purchaser and seller in accordance with their ownership interests as determined on each determination date as each separate contingency is resolved.

Comments are also requested on the requirement that the assets of a contingent at-closing escrow must be distributable to the purchaser or seller based on bona fide contingencies that are resolved after the sale or exchange. Issues may arise as to whether a particular contingency is bona fide in at least two ways: whether the outcome is sufficiently in doubt and whether the effect of the outcome on the fund is significant. A contingency may not be bona fide if the parties can reasonably be expected to know the outcome, e.g., a contingency based on whether, in ten years, the consumer price index will be at least equal to the consumer price index today. In addition, a contingency may not be bona fide if the effect on the fund is minimal even though the outcome is uncertain.

Finally, comments are requested regarding whether there are other types of funds for which rules under section 468B are required.

7. Proposed Effective Date

In general, the regulations are proposed to be applicable for QSFs, qualified escrow accounts and qualified trusts, pre-closing escrows, contingent at-closing escrows, and DOFs established after the date final regulations are published in the **Federal Register**. However, the proposed regulations contain transition rules.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 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. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. An initial regulatory flexibility analysis has been prepared for the collections of information contained in this notice of proposed rulemaking under 5 U.S.C. 603. The analysis is set forth below.

Initial Regulatory Flexibility Act Analysis

The objective of the proposed regulations is to ensure that the income of certain escrow accounts, trusts, and funds is subject to current taxation by identifying the proper party or parties subject to tax and by requiring appropriate information reporting for the income of the escrow account, trust, or fund. Section 468B(g) provides the legal basis for the requirements of the proposed regulations. The IRS and Treasury Department are not aware of any federal rules that may duplicate, overlap, or conflict with the proposed regulations.

An explanation is provided below of the burdens on small entities resulting from the requirements of the proposed regulations. Also, a description is provided of alternative rules that were considered by the IRS and the Treasury Department but rejected as too burdensome.

1. Grantor Trust Election Under § 1.468B–1(k)

Under § 1.468B–1(k), the transferor to a QSF may elect to have the QSF treated as a grantor trust all of which is treated as owned by the transferor (grantor trust election). If the transferor makes the grantor trust election, the administrator of the QSF must file Form 1041 rather than the QSF income tax return, Form 1120–SF.

Approximately 900 QSF returns are filed each year. Only a small number of these returns are filed for newly created QSFs. Because a grantor trust election may be made only for the year in which a QSF is established, and may only be made for a QSF that has one transferor, the IRS and Treasury Department believe that a very small number of grantor trust elections will be made each year.

Because of the availability of the grantor trust election, the proposed regulations provide a choice of filing Form 1041 or Form 1120–SF in certain situations. Small entities may choose the filing requirement that is less burdensome.

The alternative to the proposed regulations is to retain the current rules for QSFs and not provide qualifying taxpayers with the opportunity to make a grantor trust election.

2. Qualified Escrow Accounts and Qualified Trusts Established in Connection With Deferred Exchanges; Pre-closing Escrows; and Contingent At-Closing Escrows

Sections 1.468B–6(e)(1), 1.468B–7(d), and 1.468B–8(g)(1) require specified escrow holders, trustees, and administrators to file Forms 1099 with the IRS and furnish payee statements in accordance with the information reporting requirements of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code.

Also, § 1.468B–6(f) requires the parties to a qualified escrow account or qualified trust to provide a statement to the escrow holder or trustee if the qualified intermediary or transferee has all the beneficial use and enjoyment of the assets of the escrow account or trust. This statement facilitates the filing of Forms 1099 by the escrow holder or trustee.

Similarly, § 1.468B–8(f) requires the parties to a contingent at-closing escrow to provide statements to the escrow holder or other administrator. These statements facilitate the filing of Forms 1099 by the escrow holder or other administrator.

The IRS and Treasury Department estimate that annually there are approximately 16,000 deferred exchange transactions involving the creation of a qualified escrow account or qualified trust; approximately 200,000 transactions involving the creation of a pre-closing escrow; and approximately 10,000 transactions involving the creation of a contingent at-closing escrow.

As an alternative to the proposed regulations, the IRS and the Treasury Department considered, but rejected as too burdensome, a rule that would have required the filing of grantor trust returns (Form 1041) for qualified escrow accounts and qualified trusts, pre-closing escrows, and contingent at-closing escrows. Instead of requiring grantor trust returns, the proposed regulations require the filing of Forms 1099. This is less burdensome on small entities because, unlike Form 1041, Form 1099 is simple, does not require a signature, and requires only the reporting of gross income.

Further, the IRS and the Treasury Department considered an alternative rule for contingent at-closing escrows under which the income of the escrow for the period before the determination date would have been taxable to the purchaser or the seller depending on the required tax treatment by the purchaser and seller of the principal amount deposited into the escrow. This alternative rule would not have provided certainty, would have required a difficult legal analysis (namely, the determination of the required tax treatment of the principal amount deposited into the escrow), and would have required the purchaser and seller to provide a signed statement to the administrator of the escrow identifying the party to whom the administrator should report the income for the period before the determination date. Under the proposed regulations, the income of the escrow is always taxable to the purchaser for the period before the determination date, thereby eliminating the need for a signed statement to be provided to the administrator and the need to determine the required tax treatment of the principal amount deposited into the escrow. This rule is simpler than the alternative.

3. Disputed Ownership Funds (DOFs)

Section 1.468B–9(c)(1) of the proposed regulations generally provides that a DOF is taxable as a QSF if all its assets are passive investment assets or taxable as a C corporation in all other cases. However, the regulations also provide that if there is a more appropriate method of taxing a DOF, the claimants to the fund may request a private letter ruling to permit the use of that method.

Section 1.468B–9(f)(3) of the proposed regulations requires that a transferor provide a statement to the administrator of a DOF that itemizes the cash or property transferred to the DOF during the calendar year. The statement must also indicate the DOF's basis and holding period in the property.

The IRS and the Treasury Department estimate that annually there are approximately 5,000 transactions involving the creation of a disputed ownership fund.

As an alternative to the proposed regulations, the IRS and the Treasury Department considered, but rejected as too burdensome, a rule that would have required all DOFs to file corporate income tax returns (Form 1120) regardless of the nature of the assets held by the DOF. This alternative was rejected because it was concluded that a QSF return (Form 1120–SF) is more appropriate than a corporate income tax return if all the assets of the DOF are passive investment assets. The proposed regulations thus impose less of an administrative burden on small entities than would have resulted from the alternative rule as Form 1120–SF is generally easier to prepare than Form 1120. Only DOFs that hold assets other than passive investment assets will be required to file Form 1120 under the proposed regulations. In addition, the proposed regulations provide taxpayers with the additional flexibility of being able to request an alternative method of taxation if that method is more appropriate than QSF or C corporation treatment as provided under the general rule.

There are no known alternative rules that are less burdensome to small entities but that accomplish the purpose of the statute. The IRS and Treasury Department request comments from small entities concerning possible alternatives to these rules.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely (in the manner described in the **ADDRESSES** portion of the preamble) to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing is scheduled for May 12, 1999, at 10 a.m. in Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments by May 3, 1999 and submit an outline of the topics to be discussed and the time devoted to each topic (signed original and eight (8) copies) by April 21, 1999.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Michael L. Gompertz of the Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

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

§ 1.468B–6 also issued under 26 U.S.C. 468B.

§ 1.468B–7 also issued under 26 U.S.C. 468B.

§ 1.468B–8 also issued under 26 U.S.C. 468B.

§ 1.468B–9 also issued under 26 U.S.C. 468B. * * *

Par. 2. Section 1.468B–0 is amended as follows:

1. The introductory text is revised.
2. The entry for § 1.468B–1, paragraph (k), is redesignated as paragraph (l).
3. A new entry for § 1.468B–1, paragraph (k), is added.
4. The section heading in the entry for § 1.468B–5 is revised.
5. New entries are added for §§ 1.468B–5, paragraph (c), 1.468B–6, 1.468B–7, 1.468B–8, and 1.468B–9.
6. The revised and added provisions read as follows:

§ 1.468B–0 Table of contents.

This section lists the table of contents for §§ 1.468B–1 through 1.468B–9.

Par. 3. Section 1.468B–1 is amended by redesignating paragraph (k) as paragraph (l) and adding a new paragraph (k) to read as follows:

§ 1.468B–1 Qualified settlement funds.

* * * * *

(k) *Election to treat a qualified settlement fund as a subpart E trust*—(1) *In general.* If a qualified settlement fund has only one transferor (see paragraph (d)(1) of this section for the definition of transferor), the transferor may make an irrevocable election (grantor trust election) to treat the qualified settlement fund as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder. A grantor trust election may be made whether or not the qualified settlement fund would be classified, in the absence of paragraph (b) of this section, as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder.

(2) *Manner of making grantor trust election*—(i) *In general.* To make a grantor trust election, a transferor must attach an election statement satisfying the requirements of paragraph (k)(2)(ii) of this section to a timely filed (including extensions) Form 1041 that the administrator files on behalf of the qualified settlement fund for the taxable year in which the qualified settlement fund is established. However, if a Form 1041 would not otherwise be required to be filed (for example, because the provisions of § 1.671–4(b) are applicable), then the transferor makes a grantor trust election by attaching an election statement satisfying the requirements of paragraph (k)(2)(ii) of this section to a timely filed (including extensions) income tax return of the transferor for the taxable year in which the qualified settlement fund is established.

(ii) *Requirements for election statement.* The election statement must include a statement by the transferor that the transferor will treat the qualified settlement fund as a grantor trust. The election statement must also include the transferor's name, signature, address, taxpayer identification number, and the legend, ''§ 1.468B–1(k) Election''. The election statement and the statement described in § 1.671–4(a) may be combined into a single statement.

(3) *Effect of making the election.* If a grantor trust election is made—

(i) Paragraph (b) of this section, and §§ 1.468B–2, 1.468B–3, and 1.468B–5 do not apply to the qualified settlement fund. However, this section (except for paragraph (b) of this section) and § 1.468B–4 apply to the qualified settlement fund;

(ii) The qualified settlement fund is treated for federal income tax purposes as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder;

(iii) The transferor must take into account in computing the transferor's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the qualified settlement fund in accordance with § 1.671–3(a)(1); and

(iv) The reporting obligations imposed by § 1.671–4 on the trustee of a trust apply to the administrator.

* * * * *

Par. 4. Section 1.468B–5 is amended by revising the section heading and adding paragraph (c) to read as follows:

§ 1.468B–5 Effective dates and transition rules applicable to qualified settlement funds.

* * * * *

(c) *Grantor trust elections under § 1.468B–1(k)*—(1) *In general.* A transferor may make a grantor trust election under § 1.468B–1(k) only if the qualified settlement fund is established after the date of publication of final regulations in the **Federal Register**.

(2) *Qualified settlement funds established by the U.S. government on or before the date of publication of final regulations in the* **Federal Register**. If the U.S. government, or any agency or instrumentality thereof, establishes a qualified settlement fund on or before the date of publication of final regulations in the **Federal Register**, and the fund would have been classified as a trust all of which is treated as owned by the U.S. government under section 671 and the regulations thereunder without regard to the regulations under section 468B, then the U.S. government is deemed to have made a grantor trust election under § 1.468B–1(k), and the election is effective for all taxable years of the fund.

Par. 5. Sections 1.468B–6 through 1.468B–9 are added to read as follows:

§ 1.468B–6 Qualified escrow accounts and qualified trusts used in deferred exchanges of like-kind property under section 1031(a)(3).

(a) *Scope.* This section provides rules under section 468B(g) relating to the current taxation of income of a qualified escrow account or qualified trust established in connection with a deferred exchange under section 1031(a)(3).

(b) *Definitions.* As used in this section, *deferred exchange, relinquished property, replacement property, qualified escrow account, qualified trust, qualified intermediary, exchange period*, and *escrow holder* have the same meanings as in § 1.1031(k)–1. Also, as used in this section, *taxpayer* means the transferor of the relinquished property, and *transferee* means the person who is treated as owning the relinquished property for federal income tax purposes after its transfer by the taxpayer. Further, *owner* means the person treated as owning the assets of the qualified escrow account or qualified trust under paragraph (c) of this section.

(c) *Income of qualified escrow account or qualified trust*—(1) *In general.* Except as otherwise provided in paragraph (c)(2) of this section, and except for purposes of determining whether a transaction qualifies as a deferred exchange, the taxpayer is the owner. Thus, the taxpayer must take into account in computing the taxpayer's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the qualified escrow account or qualified trust.

(2) *Transferee or qualified intermediary has all the beneficial use and enjoyment of assets of a qualified escrow account or qualified trust.* If the transferee or the qualified intermediary has all the beneficial use and enjoyment of assets of a qualified escrow account or qualified trust, the transferee or qualified intermediary is the owner. Thus, the transferee or qualified intermediary must take into account in computing its income tax liability all items of income, deduction, and credit (including capital gains and losses) of the account or trust. The following factors, and other relevant facts and circumstances in a particular case, will be considered in determining whether the transferee or the qualified intermediary, rather than the taxpayer, has the beneficial use and enjoyment of assets of an account or trust and thus is the owner—

(i) Which person enjoys the use of the earnings of the account or trust;

(ii) Which person receives the benefit from appreciation, if any, in the value of the assets of the account or trust; and

(iii) Which person is subject to a risk of loss from a decline, if any, in the value of the assets of the account or trust.

(d) *Application of section 7872.* If the transferee or the qualified intermediary is the owner under paragraph (c)(2) of this section, section 7872 may apply if the deferred exchange involves a below-market loan from the taxpayer to the owner. See section 7872(c)(1) for the loans to which section 7872 applies.

(e) *Reporting obligations of the escrow holder or trustee*— (1) *In general.* The escrow holder of a qualified escrow account and the trustee of a qualified trust must, for each calendar year (or portion thereof) that the account or trust is in existence, report the income of the account or trust on Forms 1099 in accordance with the information reporting requirements of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code. The Forms 1099 must show the escrow holder or trustee as the payor and must show the proper payee. See paragraph (e)(2) of this section for the determination of the proper payee.

(2) *Person treated as payee.* In satisfying the reporting obligations of paragraph (e)(1) of this section, the following rules apply to the escrow holder of a qualified escrow account and the trustee of a qualified trust—

(i) If no written statement described in paragraph (f) of this section is provided to the escrow holder or trustee, the escrow holder or trustee must treat the taxpayer as the owner and the payee of the income of the account or trust; and

(ii) If a written statement described in paragraph (f) of this section is provided to the escrow holder or trustee, the escrow holder or trustee must treat the person specified on the statement (see paragraph (f)(3) of this section) as the owner and the payee of the income of the account or trust.

(3) *Relief from penalties for filing incorrect information return or payee statement.* For purposes of sections 6721 and 6722, the escrow holder of a qualified escrow account or trustee of a qualified trust will not be treated as failing to file or furnish a correct information return or payee statement solely because, in preparing a Form 1099, the escrow holder or trustee relies on a statement described in paragraph (f) of this section and therefore treats the

person specified on the statement (see paragraph (f)(3) of this section) as the owner and the payee of the income of the account or trust. If a statement described in paragraph (f) of this section is not provided to the escrow holder or trustee, the escrow holder or trustee will not be treated as failing to file or furnish a correct information return or payee statement solely because, in preparing a Form 1099, the escrow holder or trustee relies on the absence of the statement and therefore treats the taxpayer as the owner and the payee of the income of the account or trust.

(f) *Statement provided to escrow holder or trustee.* If under paragraph (c)(2) of this section, the qualified intermediary or transferee is the owner, the taxpayer and the owner must furnish to the escrow holder or trustee a statement that—

(1) Is signed by the taxpayer and the owner;

(2) Is furnished to the escrow holder or trustee within 30 days after the taxpayer transfers the relinquished property; and

(3) Specifies the person treated as the owner and thus as the payee of the income of the account or trust.

(g) *Effective date*—(1) *In general.* This section applies to qualified escrow accounts and qualified trusts established after the date of publication of final regulations in the **Federal Register**.

(2) *Transition rule.* With respect to a qualified escrow account or qualified trust established after August 16, 1986, but on or before the date of publication of final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the account or trust. The Internal Revenue Service will also not challenge a reasonable, consistently applied method for reporting such income.

(h) *Examples.* The provisions of this section may be illustrated by the following examples in which T is the taxpayer, B is the transferee, and QI is the qualified intermediary:

Example 1. (i) T uses the calendar year as the taxable year and the cash receipts and disbursements method of accounting. T enters into a deferred exchange agreement with B. Under the agreement, T will transfer property (the relinquished property) to B, and B must transfer to T within the exchange period consideration (cash or replacement property or both) having the same market value as that of the relinquished property. B's obligations under the agreement are secured by the assets of a qualified escrow account. The deferred exchange does not involve the use of a qualified intermediary.

(ii) Under the agreement, B must deposit cash into the qualified escrow account equal to the agreed upon fair market value of the relinquished property on the date the property is transferred to B. The agreement provides that the cash deposited into the escrow account must be invested in a money market fund.

(iii) The agreement provides that B is entitled to receive the interest earned on the escrow account in consideration for B's performance of services in connection with the exchange.

(iv) On September 1, 1999, T transfers the relinquished property to B. The property is unencumbered and has a fair market value of $100,000 on September 1, 1999. B deposits $100,000 into a qualified escrow account. The $100,000 is invested in accordance with the exchange agreement in a money market fund. During 1999, $2,000 of interest is earned on the escrow account. During January 2000, an additional $400 of interest is earned on the escrow account. On February 1, 2000, B uses $100,000 of the funds in the escrow account to purchase replacement property identified by T, and on this same date B transfers the replacement property to T. The interest earned on the escrow account, $2,400, is paid to B from the escrow account in consideration for B's performance of services.

(v) Paragraph (c)(1) of this section applies and T must take into account in computing T's income tax liability for 1999 and 2000 the $2400 of interest earned on the escrow account in those years even though the interest is paid to B as compensation for B's services. Paragraph (c)(1) of this section applies for the following reasons. T, rather than B, enjoys the use of the earnings of the escrow account since the earnings are used to discharge T's obligation to pay B for B's services. B is not considered to have all the beneficial use and enjoyment of the assets of the escrow account merely because the compensation that B is entitled to receive is based on the earnings of the escrow account.

(vi) The escrow holder must file Forms 1099 for 1999 and 2000 and furnish T with payee statements with respect to the interest earned on the escrow in 1999 and 2000. See paragraph (e)(1) of this section.

Example 2. (i) The facts are the same as in *Example 1* except that the agreement between B and T requires B to pay $100,000 to QI; under the agreement between T and QI, QI is obligated to transfer to T within the exchange period consideration (cash or replacement property or both) equal to $100,000 plus interest thereon at 4 percent compounded semiannually; QI's obligation to transfer this consideration is secured by the $100,000 received from B, which QI must deposit into a qualified escrow account; the assets of the escrow account must be invested in a money market fund; and, as compensation for QI's performance of services to facilitate the deferred exchange, QI is entitled to receive the excess of the interest earned on the escrow account over the amount of interest (computed at 4 percent compounded semiannually) payable to T in cash or property.

(ii) QI deposits the $100,000 received from B into a qualified escrow account, and the $100,000 is invested in a money market fund earning interest at 4.8 percent compounded semiannually. During 1999, $1,600 of interest is earned on the escrow account. During January 2000, an additional $400 of interest is earned on the escrow account. On February 1, 2000, QI uses $101,667 of the funds in the escrow account to purchase replacement property, which is transferred to T. This transfer satisfies QI's obligations under the agreement because $1,667 is the amount of interest that is earned on $100,000 at 4 percent compounded semiannually for 5 months. Of the $2,000 in interest earned on the escrow account in 1999 and 2000, $1,667 is used to purchase replacement property, and the remaining $333 is paid in cash to QI as compensation for QI's services.

(iii) Paragraph (c)(1) of this section applies and T must take into account in computing T's income tax liability for 1999 and 2000 the $2000 of interest earned on the escrow account in those years even though $333 of the interest is paid to QI as compensation for QI's services.

(iv) The escrow holder must file Forms 1099 and furnish T with payee statements with respect to the $2000 of interest earned on the escrow in 1999 and 2000. See paragraph (e)(1) of this section.

§ 1.468B–7 Pre-closing escrows.

(a) *Scope.* This section provides rules under section 468B(g) for the taxation of income earned on pre-closing escrows.

(b) *Definition.* A *pre-closing escrow* is an escrow account, trust, or fund—

(1) Established in connection with the sale or exchange of real or personal property;

(2) Funded with a down payment, earnest money, or similar payment that is deposited into the escrow prior to the sale or exchange of the property;

(3) Used to secure the obligation of the purchaser to pay the purchase price for the property (in the case of an exchange, *purchaser* means the transferee of the property, and *purchase price* means the required consideration for the property);

(4) The assets of which, including the income earned thereon, will be paid to the purchaser or otherwise distributed for the purchaser's benefit when the property is sold or exchanged (for example, by being distributed to the seller as a credit against the purchase price); and

(5) Which is not a qualified escrow account or qualified trust established in connection with a deferred exchange under section 1031(a)(3).

(c) *Taxation of pre-closing escrows.* The purchaser is treated for federal income tax purposes as owning the assets of a pre-closing escrow. Thus, the purchaser must take into account in computing the purchaser's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the escrow.

(d) *Reporting obligations of the administrator.* For each calendar year (or portion thereof) that a pre-closing escrow is in existence, the escrow agent, escrow holder, trustee, or other person responsible for administering the escrow (the *administrator*) must report the income of the escrow on Forms 1099 in accordance with the information reporting requirements of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code. The Form 1099 must show the administrator as the payor and the purchaser as the payee.

(e) *Effective date*—(1) *In general.* The provisions of this section apply to pre-closing escrows established after the date of publication of final regulations in the **Federal Register**.

(2) *Transition rule.* With respect to a pre-closing escrow established after August 16, 1986, but on or before the date of publication of final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the escrow. The Internal Revenue Service will also not challenge a reasonable, consistently applied method for reporting such income.

(f) *Example.* The provisions of this section may be illustrated by the following example:

Example. P enters into a contract with S for the purchase of residential property owned by S for the price of $200,000. P is required to deposit $10,000 of earnest money into an escrow. At closing, the $10,000 and the interest earned thereon will be credited against the purchase price of the property. The escrow is a pre-closing escrow. P is treated as owning the assets of the escrow, and P is taxable on the interest earned on the escrow prior to closing. The escrow holder must report the income earned on the escrow on Forms 1099 and furnish payee statements to P. The Forms 1099 must show the escrow holder as the payor and P as the payee.

§ 1.468B–8 Contingent at-closing escrows.

(a) *Scope.* This section provides rules under section 468B(g) for the taxation of income earned on a contingent at-closing escrow, which is defined in paragraph (b) of this section. No inference should be drawn from this section concerning the tax treatment of a contingent at-closing escrow, or of parties to the escrow, under sections of the Internal Revenue Code other than section 468B. See also paragraph (d) of this section.

(b) *Definitions.* For purposes of this section, the following definitions apply—

Administrator means an escrow agent, escrow holder, trustee, or other person responsible for administering an escrow account, trust, or fund (the purchaser or the seller may be the administrator);

Contingent at-closing escrow means an escrow account, trust, or fund that satisfies the following requirements—

(1) The escrow is established in connection with the sale or exchange (other than an exchange to which section 354, 355, or 356 applies) of real or personal property used in a trade or business or held for investment (including stock in a corporation or an interest in a partnership);

(2) Depending on whether events specified in the agreement between the purchaser and the seller that are subject to bona fide contingencies (not including events that are certain, or reasonably certain, to occur, such as the passage of time, or that are certain, or reasonably certain, not to occur) either occur or fail to occur, the escrow's assets (except for assets set aside for taxes or expenses) will be distributable—

(i) Entirely to the purchaser;

(ii) Entirely to the seller; or

(iii) In part, to the purchaser with the remainder to the seller; and

(3) The escrow is not a qualified escrow account or qualified trust established in connection with a deferred exchange under section 1031(a)(3);

Determination date means the date on which (or by which) the last of the events subject to a bona fide contingency specified in the agreement between the purchaser and the seller (referred to in the definition of *contingent at-closing escrow*) has either occurred or failed to occur;

Purchaser means, in the case of an exchange of property, the transferee of the property; and

Seller means, in the case of an exchange of property, the transferor of the property.

(c) *Tax liability of purchaser and seller for the period prior to the determination date.* For the period prior to the determination date, the purchaser is treated as owning the assets of the contingent at-closing escrow for federal income tax purposes. Thus, in computing the purchaser's income tax liability, the purchaser must take into account all items of income, deduction, and credit (including capital gains and losses) of the escrow until the determination date.

(d) *Transfer of interest in the assets of the escrow on the determination date.* No inference should be drawn from this section whether, for purposes of Internal Revenue Code sections other than 468B, there is a transfer of ownership of the assets of a contingent at-closing escrow on the determination date from the purchaser to the seller or from the seller to the purchaser, or the tax consequences of such a transfer. Thus, for example, if there is a transfer of ownership of the assets of the escrow from the purchaser to the seller on the determination date for purposes of other Code sections, no inference should be drawn from this section whether any portion of the amount transferred is unstated interest. See § 1.483–4.

(e) *Tax liability of purchaser and seller for the period beginning on the determination date.* For the period beginning on the determination date, the purchaser and the seller must each take into account in determining their income tax liabilities the income, deductions, and credits (including capital gains and losses) corresponding to their ownership interests in the assets of the escrow.

(f) *Statement required to be provided to administrator within 30 days after the determination date.* Within 30 days after the determination date, the purchaser and the seller must provide the administrator with a written statement that—

(1) Is signed by the purchaser and the seller;

(2) Specifies the determination date; and

(3) Specifies the purchaser's and seller's ownership interests in each asset of the escrow.

(g) *Reporting obligations of the administrator*—(1) *In general.* The administrator of a contingent at-closing escrow must, for each calendar year (or portion thereof) that the escrow is in existence, report the income of the escrow on Forms 1099 in accordance with the information reporting requirements of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code. The Forms 1099 must show as payor the administrator of the escrow and as payee the person (or persons) treated as the payee (or payees) under paragraph (g)(2) of this section.

(2) *Person treated as payee.* In satisfying the reporting obligations of paragraph (g)(1) of this section, the following rules apply to the administrator—

(i) For the period prior to the determination date, the administrator must treat the purchaser as the payee of the income of the escrow;

(ii) For the period beginning on the determination date, if the written statement described in paragraph (f) of this section is timely provided to the administrator, the administrator must treat as the payee (or payees) of the income of the escrow the purchaser or seller (or both) in accordance with their respective ownership interests as shown on the statement; and

(iii) If the written statement described in paragraph (f) of this section is not provided to the administrator, the administrator must continue to treat the purchaser as the payee of the income of the escrow.

(3) *Relief from penalties for filing incorrect information return or payee statement.* For purposes of sections 6721 and 6722, the administrator will not be treated as failing to file or furnish a correct information return or payee statement solely because, in preparing a Form 1099, the administrator relies on a statement described in paragraph (f) of this section and therefore treats the purchaser or seller (or both) as the payee (or payees) of the income of the escrow in accordance with their respective ownership interests in the assets of the escrow as shown on the statement. If a statement described in paragraph (f) of this section is not provided to the administrator, the administrator will not be treated as failing to file or furnish a correct information return or payee statement solely because, in preparing a Form 1099, the administrator relies on the absence of the statement and therefore treats the purchaser as the payee.

(h) *Effective date*—(1) *In general.* The provisions of this section apply to contingent at-closing escrows that are established after the date of publication of final regulations in the **Federal Register**.

(2) *Transition rule.* With respect to a contingent at-closing escrow established after August 16, 1986, but on or before the date of publication of final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the escrow. The Internal Revenue Service will also not challenge a reasonable, consistently applied method for reporting such income.

(i) [Reserved]

(j) *Example.* The provisions of this section may be illustrated by the following example:

Example. (i) P and S are corporations. In 1999, P enters into a contract with S for the purchase of rental real estate. On October 1, 1999, the date of sale, S transfers the real estate to P, and P pays S a portion of the purchase price, $9,000,000. P deposits the remaining portion of the purchase price, $850,000, into an escrow account as required by the contract. H is the escrow holder.

(ii) The contract provides that the escrow balance as of November 1, 2000, is payable entirely to P, entirely to S, or partially to P and partially to S depending on the amount, if any, by which the average rental income from the real estate during a specified testing period ending on September 30, 2000, exceeds one or more specified earnings targets.

(iii) According to the terms of the contract, the income earned on the escrow must be accumulated and is not currently distributable to P or S during the period prior to November 1, 2000.

(iv) During the testing period specified in the contract between P and S, the average rental income earned on the property exceeds one (but not all) of the specified earnings targets. As a result, on September 30, 2000, the end of the testing period, P became entitled to 40% of the escrow assets and S became entitled to 60% of the escrow assets.

(v) On October 30, 2000, P and S provide H with the written statement described in paragraph (f) of this section. The written statement is thus provided within 30 days of September 30, 2000. The statement indicates that P's ownership interest in each asset of the escrow is 40 percent and S's ownership interest in each asset is 60 percent.

(vi) The escrow is a contingent at-closing escrow. September 30, 2000, is the determination date because this is the date on which the testing period ends. As of this date, all contingencies specified in the contract are resolved.

(vii) P must take into account all of the income, deductions, and credits (including capital gains and losses) of the escrow in computing P's income tax liability for the period prior to September 30, 2000. See paragraph (c) of this section.

(viii) For the period beginning on September 30, 2000, P must take into account in computing P's income tax liability 40 percent of each item of income, deduction, and credit of the escrow (including capital gains and losses), and S must take into account in computing S's income tax liability 60 percent of these items. See paragraph (e) of this section.

(ix) H is subject to the information reporting requirements of paragraph (g)(1) of this section. H must file Forms 1099 and furnish payee statements to reflect the fact that prior to September 30, 2000, P is the payee of all the income of the escrow, and for the period beginning on September 30, 2000, P is the payee of 40 percent of the income, and S is the payee of 60 percent of the income.

§ 1.468B–9 Disputed ownership funds.

(a) *In general.* An escrow account, trust, or fund that is not a qualified settlement fund is a disputed ownership fund if—

(1) It is established to hold money or property subject to conflicting claims of ownership;

(2) The escrow account, trust, or fund is subject to the continuing jurisdiction of a court; and

(3) Money or property cannot be paid or distributed from the escrow account, trust, or fund to, or on behalf of, a claimant or a transferor without the approval of the court.

(b) *Definitions.* For purposes of this section—

(1) *Administrator* means the person designated as such by the court having jurisdiction over a disputed ownership fund. If no person is designated, the administrator is the escrow agent, escrow holder, trustee, receiver, or other person responsible for administering the fund;

(2) *Claimant* means a person, including a transferor, who claims ownership of, or a legal or equitable interest in, money or property held by a disputed ownership fund;

(3) *Court* means a court of law or equity of the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof;

(4) *Related person* means any person who is related to the transferor within the meaning of section 267(b) or 707(b)(1);

(5) *Transferor* means, in general, a person that transfers to a disputed ownership fund money or property that is subject to conflicting claims of claimants. However, a payor of interest or other income earned by a disputed ownership fund is not a transferor (unless the payor is also a claimant). A transferor may also be a claimant.

(c) *Taxation of a disputed ownership fund*—(1) *In general.* For federal income tax purposes, a disputed ownership fund is treated as the owner of all assets that it holds. A disputed ownership fund is treated as a C corporation for purposes of subtitle F of the Internal Revenue Code, and the administrator of the fund must obtain an employer identification number for the fund, make all required income tax and information returns, and deposit all payments of tax. Also, except as otherwise provided in this section, a disputed ownership fund is taxable as if it were either—

(i) A qualified settlement fund under § 1.468B–2 if all the assets transferred to the fund by or on behalf of transferors are passive investment assets, for example, cash or cash equivalents, stock, and debt obligations; or

(ii) A C corporation in all other cases.

(2) *Exception.* If there is a more appropriate method of taxing a disputed ownership fund than as provided in paragraph (c)(1) of this section, the claimants to the fund may submit a private letter ruling request proposing an alternative method of taxation.

(3) *Special rules.* (i) In general, money or property subject to conflicting claims of claimants (disputed property) that is transferred to a disputed ownership fund by, or on behalf of, a transferor is excluded from the gross income of the fund. However, this exclusion does not

apply to income earned on assets of the fund such as—

(A) Payments to a disputed ownership fund made in compensation for late or delayed transfers of money or property;

(B) Dividends on stock of a transferor (or a related person) held by the fund; and

(C) Interest on debt of a transferor (or a related person) held by the fund.

(ii) A distribution to a claimant of disputed property by a disputed ownership fund is not a taxable event to the fund.

(iii) A disputed ownership fund is not allowed a deduction for a distribution of disputed property to, or on behalf of, a transferor or a claimant.

(iv) Upon the termination of a disputed ownership fund, if the fund has an unused net operating loss carryover under section 172, an unused capital loss carryover under section 1212, or an unused tax credit carryover, or if the fund has, for its last taxable year, deductions in excess of gross income, the claimant to whom the fund's net assets are distributable will succeed to and take into account the fund's unused net operating loss carryover, unused capital loss carryover, unused tax credit carryover, or excess of deductions over gross income for the last taxable year of the fund. If the fund's net assets are distributable to more than one claimant, the unused net operating loss carryover, unused capital loss carryover, unused tax credit carryover, or excess of deductions over gross income for the last taxable year must be allocated among the claimants in proportion to the value of the assets distributable to each claimant from the fund.

(v) In the case of a disputed ownership fund taxable as if it were a C corporation under paragraph (c)(1)(ii) of this section, this section does not, in general, restrict the fund's use of an otherwise allowable method of accounting or taxable year.

(vi) Appropriate adjustments must be made by a disputed ownership fund or transferors to the fund to prevent the fund and the transferors from taking into account the same item of income, deduction, gain, loss, or credit more than once or from omitting such items.

(d) *Basis of property held by a disputed ownership fund.* In general, the initial basis of property transferred by, or on behalf of, a transferor to a disputed ownership fund is the fair market value of the property on the date of transfer to the fund as determined by the transferor for purposes of the rules in paragraph (f)(1)(i) of this section. However, if paragraph (f)(1)(ii) of this section applies, the fund's initial basis in the property is the same as the basis of the transferor immediately before the transfer to the fund.

(e) *Request for prompt assessment.* A disputed ownership fund is eligible to request the prompt assessment of tax under section 6501(d). For purposes of section 6501(d), a disputed ownership fund is treated as dissolving on the date the fund no longer has any assets (other than a reasonable reserve for potential tax liabilities and related professional fees) and will not receive any more transfers.

(f) *Rules applicable to the transferor*—(1) *Transfer of property*—(i) *In general.* A transferor must treat a transfer of property to a disputed ownership fund as a sale or other disposition of that property for purposes of section 1001(a). In computing the gain or loss, the amount realized by the transferor is the fair market value of the property on the date the transfer is made to the disputed ownership fund.

(ii) *Exceptions.* A transfer of property to a disputed ownership fund is not a sale or other disposition of the property for purposes of section 1001(a) if—

(A) The transferor claims ownership of the transferred property immediately before and immediately after the transfer to the fund; or

(B) The transferor is an agent, fiduciary, or other person acting in a similar capacity acting on behalf of a person claiming ownership of the transferred property immediately before and immediately after the transfer to the fund.

(2) *Economic performance*—(i) *In general.* For purposes of section 461(h), if a transferor has a liability to one or more claimants for which economic performance would otherwise occur under § 1.461–4(g) when the transferor makes a payment to the claimant or claimants, economic performance occurs with respect to the liability to the extent the transferor makes a transfer to a disputed ownership fund to resolve or satisfy that liability, but only if the transferor and related persons are not claimants and have no right to receive payments or distributions from the fund.

(ii) *Obligations of the transferor.* With respect to a transferor described in paragraph (f)(2)(i) of this section, economic performance does not occur when the transferor transfers to a disputed ownership fund its debt (or the debt of a related person). Instead, economic performance occurs as the transferor (or related person) makes principal payments on the debt. Similarly, economic performance does not occur when the transferor transfers to a disputed ownership fund its obligation (or the obligation of a related person) to provide property in the future or to make a payment described in § 1.461–4(g). Instead, economic performance occurs with respect to such an obligation as property or payments are provided or made to the disputed ownership fund or a claimant.

(3) *Statement to the disputed ownership fund and the Internal Revenue Service*—(i) *In general.* By February 15 of the year following each calendar year in which a transferor (or other person acting on behalf of a transferor) makes a transfer to a disputed ownership fund, the transferor (or other person) must provide a statement to the administrator of the fund setting forth the information described in paragraph (f)(3)(ii) of this section. The transferor must attach a copy of the statement to (and as part of) its timely filed income tax return (including extensions) for the taxable year of the transferor in which the transfer is made.

(ii) *Information required on statement*—(A) *In general.* The statement required by paragraph (f)(3)(i) of this section must include the following information—

(*1*) A legend, ''§ 1.468B–9(f) Statement'', at the top of the first page;

(*2*) The transferor's name, address, and taxpayer identification number;

(*3*) The disputed ownership fund's name, address, and employer identification number;

(*4*) The date of each transfer;

(*5*) The amount of cash transferred;

(*6*) A description of property transferred, the disputed ownership fund's basis in the property as provided in paragraph (d) of this section, and, if the rules of paragraph (f)(1)(ii) of this section apply, the fund's holding period on the date of transfer; and

(*7*) Whether or not the transferor is also a claimant.

(B) *Combined statements.* If a disputed ownership fund has more than one transferor, any two or more of the transferors may provide a combined statement to the administrator that does not identify the amount of cash or the property transferred by a particular transferor. If a combined statement is used, however, each transferor must include with its copy of the statement that is attached to its income tax return a schedule describing each asset that the transferor transferred to the disputed ownership fund.

(4) *Distributions to transferors*—(i) *In general.* A transferor must include in gross income any distribution to a transferor (including a deemed distribution described in paragraph (f)(4)(iii) of this section) from a disputed

ownership fund. If property is distributed, the amount includible in gross income and the basis in that property is generally the fair market value of the property on the date of distribution.

(ii) *Exception.* The gross income of a transferor does not include a distribution to the transferor of property from a disputed ownership fund if the transferor previously transferred the property to the fund and paragraph (f)(1)(ii) of this section applied to that transfer. Also, the transferor's gross income does not include a distribution of money from the disputed ownership fund equal to the net income earned on that property while it was held by the fund. Further, the transferor's basis in the property is the same as the disputed ownership fund's basis in the property immediately before the distribution to the transferor.

(iii) *Deemed distributions.* If a disputed ownership fund makes a distribution on behalf of a transferor to a person that is not a claimant, the distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to have made a payment to the actual recipient.

(g) *Distribution to a claimant other than a transferor.* Whether a claimant other than a transferor must include in gross income a distribution of money or property from a disputed ownership fund is generally determined by reference to the claim in respect of which the distribution is made. If a disputed ownership fund distributes property to a claimant other than a transferor in satisfaction of the claimant's claim of ownership to that property, the claimant's basis in the property must be adjusted to reflect the adjustments to the basis of the property required under section 1016 for the period the property was held by the fund.

(h) *Effective date*—(1) *In general.* This section applies to disputed ownership funds established after the date of publication of final regulations in the **Federal Register**.

(2) *Transition rule.* With respect to a disputed ownership fund established after August 16, 1986, but on or before the date of publication of final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the fund, transfers to the fund, and distributions made by the fund.

(i) [Reserved].

(j) *Examples.* The following examples illustrate the rules of this section:

Example 1. (i) Prior to A's death, A was the insured under a life insurance contract (policy) issued by X, an insurance company. A's current spouse and A's former spouse each claim to be the beneficiary under the policy and thus entitled to the policy proceeds ($1 million). In 1999, X files an interpleader action and deposits the policy proceeds into the registry of the court. On June 1, 2000, a final determination is made that A's current spouse is the beneficiary under the policy and thus entitled to the funds held in the registry of the court. These funds are distributed to A's current spouse.

(ii) The funds held in the registry of the court consisting of the policy proceeds and the earnings thereon are a disputed ownership fund taxable as if it were a qualified settlement fund. See paragraph (c)(1)(i) of this section. The fund's gross income does not include the $1 million transferred to the fund by X.

Example 2. (i) Two unrelated individuals, A and B, claim ownership of certain rental property. A claims to have purchased the property from B's father. However, B asserts that the purported sale to A was ineffective and that B acquired ownership of the property through intestate succession upon the death of B's father. For several years, A has maintained the property and received the rent from the property.

(ii) Pending the resolution of the title dispute between A and B, the title to the property is transferred into a court-supervised escrow on February 1, 2000. Also, on that date the court appoints R as receiver for the property. R collects the rent earned on the property and hires employees necessary for the maintenance of the property. The rents paid to R cannot be distributed to A or B without the court's approval.

(iii) On June 1, 2001, the court makes a final determination that the rental property is owned by B. The court orders B to refund to A the purchase price paid by A to B's father plus interest on that amount from February 1, 2000. Also, the court orders that a distribution be made to B of all funds held in the court registry consisting of the rent collected by R and the income earned thereon. In addition, title to the property is returned to B.

(iv) The rental property and the funds held by the court registry are held in a disputed ownership fund.

(v) A is the transferor to the fund. A does not realize gain or loss under section 1001(a) on A's transfer of the property to the disputed ownership fund.

(vi) The fund is taxable as if it were a C corporation because the rental property is not a passive investment asset. See paragraph (c)(1)(ii) of this section. The fund is not taxable upon receipt of the property. The fund's initial basis in the property is the same as A's adjusted basis immediately before the transfer to the fund. The fund's gross income includes the rents paid to R and the income earned thereon. For the period between February 1, 2000, and June 1, 2001, the fund may be allowed deductions for depreciation and for the costs of maintenance of the property because the fund is treated as owning the property during this period. See sections 162, 167, and 168.

(vii) The fund is not allowed a deduction for the distribution to B of the rent earned on the property while held by the fund (or the income earned thereon). No tax consequences to the fund result from this distribution or from the fund's transfer of the rental property to B pursuant to the court's determination that B owns the property.

Par. 6. Section 1.1031(k)–1 is amended by adding a sentence at the end of paragraphs (g)(3)(i) and (h)(2) to read as follows:

§ 1.1031(k)–1 Treatment of deferred exchanges.

* * * * *

(g) * * *

(3) * * * (i) * * * For rules under section 468B(g) relating to the current taxation of income of a qualified escrow account or qualified trust, see § 1.468B–6.

* * * * *

(h) * * *

(2) * * * For rules under section 468B(g) relating to the current taxation of income of a qualified escrow account or qualified trust, see § 1.468B–6.

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Michael P. Dolan,

Deputy Commissioner of Internal Revenue.

[FR Doc. 99–1515 Filed 1–29–99; 8:45 am]

BILLING CODE 4830–01–U

DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Part 100

[CGD01–98–155]

RIN 2115–AE46

Special Local Regulations: Hudson Valley Triathlon, Hudson River, Kingston, New York

AGENCY: Coast Guard, DOT.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to establish permanent special local regulations for the annual Hudson Valley Triathlon. This action is necessary to provide for the safety of life on navigable waters during the event. This event is intended to restrict vessel traffic in the Hudson River, in the vicinity of Kingston Point Reach.

DATES: Comments must be received on or before April 2, 1999.

ADDRESSES: Comments may be mailed to the Waterways Oversight Branch (CGD01–98–155), Coast Guard Activities New York, 212 Coast Guard Drive, Staten Island, New York 10305, or deliver them to room 205 at the same address between 8 a.m. and 3 p.m.,