owner, and the developer must follow the appropriate Federal-aid procurement requirements (23 CFR part 172 for engineering service contracts, 23 CFR part 635 for construction contracts and the requirements of this part for design-build contracts) for all prime contracts (not subcontracts).

* * * * *

■ 15. Revise § 636.302(a)(1) to read as follows:

§ 636.302 Are there any limitations on the selection and use of proposal evaluation factors?

(a) * * *

(1) You must evaluate price in every source selection where construction is a significant component of the scope of work. However, where the contracting agency elects to release the final RFP and award the design-build contract before the conclusion of the NEPA process (see § 636.109), then the following requirements apply:

(i) It is not necessary to evaluate the total contract price;

(ii) Price must be considered to the extent the contract requires the contracting agency to make any payments to the design-builder for any work performed prior to the completion of the NEPA process and the contracting agency wishes to use Federal-aid highway funds for those activities;

(iii) The evaluation of proposals and award of the contract may be based on qualitative considerations;

(iv) If the contracting agency wishes to use Federal-aid highway funds for final design and construction, the subsequent approval of final design and construction activities will be contingent upon a finding of price reasonableness by the contracting agency;

(v) The determination of price reasonableness for any design-build project funded with Federal-aid highway funds shall be based on at least one of the following methods:

(A) Compliance with the applicable procurement requirements for part 172, 635, or 636, where the contractor providing the final design or construction services, or both, is a person or entity other than the design-builder;

(B) A negotiated price determined on an open-book basis by both the design-builder and contracting agency; or

(C) An independent estimate by the contracting agency based on the price of similar work;

(vi) The contracting agency's finding of price reasonableness is subject to FHWA concurrence.

* * * * *

[FR Doc. 07–3959 Filed 8–9–07; 3:55 pm]

BILLING CODE 4910–22–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9354]

RIN 1545–BB86

Expenses for Household and Dependent Care Services Necessary for Gainful Employment

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding the credit for expenses for household and dependent care services necessary for gainful employment. The regulations reflect statutory amendments under the Deficit Reduction Act of 1984, the Tax Reform Act of 1986, the Omnibus Budget Reconciliation Act of 1987, the Family Support Act of 1988, the Small Business Job Protection Act of 1996, the Economic Growth and Tax Relief Reconciliation Act of 2001, the Job Creation and Worker Assistance Act of 2002, the Working Families Tax Relief Act of 2004, and the Gulf Opportunity Zone Act of 2005. The regulations affect taxpayers who claim the credit for expenses for household and dependent care services, and dependent care providers.

DATES: *Effective Date:* These regulations are effective August 14, 2007.

Applicability Date: For date of applicability, see § 1.21–1(l).

FOR FURTHER INFORMATION CONTACT: Amy Pfalzgraf, (202) 622–4960 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final amendments to the Income Tax Regulations, 26 CFR part 1, relating to the credit for expenses for household and dependent care services necessary for gainful employment (the credit) under section 21 of the Internal Revenue Code (Code).

On May 24, 2006, a notice of proposed rulemaking (REG–139059–02) regarding the credit was published in the **Federal Register** (71 FR 29847). Written and electronic comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The comments and revisions are discussed in the preamble.

Explanation of Provisions and Summary of Comments

1. Time of Payment and Performance of Services

Section 21(b)(2) provides, in part, that employment-related expenses are amounts paid to enable a taxpayer to be gainfully employed for a period for which there are one or more qualifying individuals with respect to a taxpayer. The proposed regulations provide that a taxpayer may take expenses into account under section 21 only in the later of the taxable year the services are performed or the taxable year the expenses are paid. The proposed regulations also provide that the status of an individual as a qualifying individual is determined on a daily basis, that a taxpayer may take into account only expenses that qualify before a disqualifying event, such as a child turning 13, and that the requirements of section 21 and the regulations are applied at the time the services are performed, regardless of when the expenses are paid.

A verbal comment inquired whether, to be creditable, expenses must be paid and services must be performed before a disqualifying event.

The determination of whether expenses qualify as employment-related expenses, including whether an individual is a qualifying individual, can be made only at the time services are performed. Only expenses for the care of a qualifying individual that are for the purpose of enabling the taxpayer to be gainfully employed qualify for the credit. Therefore, services must be performed prior to a disqualifying event and at a time when the purpose is to enable the taxpayer to be gainfully employed. For purposes of determining whether expenses are employment-related expenses, the time of payment is irrelevant, although payment must be made before the credit is claimed. The final regulations provide examples to illustrate these rules.

2. Care of Qualifying Individual and Household Services

Under section 21(b)(2)(A), expenses are employment-related only if the expenses are primarily for household services or for the care of a qualifying

individual. The proposed regulations provide that the primary purpose of expenses for the care of a qualifying individual must be to assure that individual's well-being and protection.

a. Costs for Education

The proposed regulations provide that expenses for a child in nursery school, pre-school, or similar programs for children below the kindergarten level are for the care of a qualifying individual and may be employment-related expenses. Expenses for a child in kindergarten or a higher grade are not for care and therefore, are not employment-related expenses. However, expenses for before-or after-school care of a child in kindergarten or a higher grade may be for care.

Commentators noted that some public school systems offer only half-day kindergarten, and that some parents send their children to private kindergarten because it offers a full-day program. Under the proposed regulations, a parent whose child attends a half-day kindergarten may claim the credit for the cost of an afternoon after-school program. However, a parent whose child attends a full-day private kindergarten may not claim the credit for the cost of services performed in the afternoon, because the services are part of the kindergarten program and not after-school care. Commentators suggested that taxpayers who send their children to full-day private kindergarten should be allowed some apportionment of expenses for the afternoon portion of the kindergarten.

The final regulations do not adopt this comment. Kindergarten programs are primarily educational. See, for example, section 62(d)(1) (definitions of eligible educator and school) and section 530(b)(3)(B) (definition of school). Although nursery school and other programs below the level of kindergarten also may include significant educational elements, for administrative convenience the proposed regulations treat these programs as for care. The final regulations retain these rules for greater ease of administration.

A commentator suggested that amounts paid for sending a child to a private school by a taxpayer living overseas should be an employment-related expense if public education is not available. The final regulations do not adopt this comment. Employment-related expenses must be for the care of a qualifying individual and may not be for other services such as education.

b. Specialty Day Camps

The proposed regulations provide that the full amount paid for a day camp or similar program may be for the care of a qualifying individual although the camp specializes in a particular activity, such as soccer or computers. For administrative convenience, no allocation is required in this situation between the cost of care and amounts paid for learning a specialized skill.

A verbal comment requested that the regulations clarify that summer school is not day camp and that the cost of summer school is not creditable. Another commentator commended the proposed regulations for allowing the credit for the cost of ''education day camps'' that focus on reading, math, writing, and study skills.

The final regulations retain the rule that no allocation is required for the cost of a specialty day camp, but clarify that expenses for summer school and tutoring programs are not creditable. Summer school and tutoring programs are indistinguishable from school and are education, not care. The final regulations provide examples to illustrate these rules.

Section 21(b)(2)(C) provides, in part, that the cost of services performed by a dependent care center are employment-related expenses only if the dependent care center complies with the applicable laws of the state and local government. A commentator requested that the regulations clarify whether a day camp is a dependent care center and must comply with this requirement. The final regulations clarify that the requirements of section 21(b)(2)(C) apply to day camps that meet the definition of dependent care center in section 21(b)(2)(D).

c. Sick Child Centers

A commentator asserted that sick child centers that provide care for children with illnesses who cannot be cared for by the primary care provider primarily provide dependent care and that any medical care provided is incidental. The commentator suggested that these costs may be employment-related expenses.

The final regulations do not adopt this comment. A taxpayer may take an amount into account as either an employment-related expense under section 21 or an expense for medical care under section 213 (but not both). See section 213(e). Whether the care provided at a sick child center assures a child's well-being and protection or constitutes medical care is a factual matter that must be determined on a case-by-case basis.

d. Boarding School

The proposed regulations provide that an allocation must be made between expenses for the care of a qualifying individual and expenses for other goods or services, unless the other goods or services are incidental to and inseparably a part of the care. Specifically, amounts paid for food, lodging, clothing, or education are not for the care of a qualifying individual. The proposed regulations provide an example requiring a taxpayer to allocate the costs of a boarding school between care and education, meals, and housing.

A commentator stated that the example does not provide clear guidance for determining which expenses are for care and whether lodging and meals could be considered incidental and therefore, part of care. The commentator suggested that meals and lodging at a boarding school are incidental to and inseparably a part of the care provided.

The final regulations do not adopt this comment. The example and the regulations clearly distinguish care from food, lodging, and education provided by a boarding school, which are not for the care of a qualifying individual, or incidental to or inseparably a part of the care provided.

e. Expenses for Room and Board of a Caregiver

The proposed regulations provide that the additional cost of providing room and board for a caregiver over usual household expenses may be an employment-related expense. This rule is based on Rev. Rul. 76–288 (1976–2 CB 83), which holds that under the predecessor to section 21, a taxpayer furnishing meals and lodging to a housekeeper who provides care may deduct the allocable expenses attributable to the housekeeper that are in addition to normal household expenses. The ruling provides an example allowing a taxpayer to take into account the additional cost of rent for an apartment with an additional bedroom to accommodate the housekeeper and additional utilities attributable to the housekeeper.

The proposed regulations provide that the general substantiation rules of section 6001 and the implementing regulations apply to taxpayers claiming the credit. A commentator stated that the regulations should clarify whether an increase in utilities (such as electric, water, and gas) may be employment-related expenses and what constitutes acceptable proof of costs.

The final regulations adopt the first of these comments and include an

example similar to the example in Rev. Rul. 76–288. However, the final regulations do not provide special substantiation rules for these costs. These rules encompass substantiation of allocations by taxpayers claiming the credit with respect to the additional cost of providing room and board for a caregiver.

f. Cost of Overnight Camp

A commentator suggested that the credit should be allowed for a portion of the cost of overnight camp allocable to time when parents work. The final regulations do not adopt this comment. Under section 21(b)(2), the cost of overnight camp is not an employment-related expense.

3. Expenses Enabling a Taxpayer To Be Gainfully Employed

Under section 21(b)(2)(A), expenses are employment-related only if the taxpayer's purpose in obtaining the services is to enable the taxpayer to be gainfully employed. The expenses must be for periods during which the taxpayer is gainfully employed or is in active search of gainful employment.

a. Short, Temporary Absence Exception

The proposed regulations provide that a taxpayer must allocate the cost of care on a daily basis if expenses are paid for a period during only part of which the taxpayer is employed or in active search of gainful employment. The proposed regulations provide an exception to the allocation requirement for a short, temporary absence from work for a taxpayer paying for dependent care on a weekly, monthly, or annual basis. Whether an absence is a short, temporary absence is determined based on all the facts and circumstances. The proposed regulations requested comments on an appropriate period to constitute a temporary absence safe harbor.

A commentator suggested that the exception for short, temporary absences should not be limited to taxpayers who pay employment-related expenses on a weekly, monthly, or annual basis. The commentator stated that regardless of payment schedule, taxpayers who take their children out of care due to a short illness or vacation typically must pay for that care when absent or risk losing it.

The final regulations adopt this comment and delete the provision that the temporary absence exception applies only to taxpayers who must pay for care on a weekly, monthly, or annual basis. The final regulations clarify, however, that only those costs that the taxpayer is required to pay during the absence qualify for the exception. The final regulations provide examples to illustrate these rules.

A commentator suggested that a length of absence that is less than a taxpayer's pay period should be deemed to be a short, temporary absence for that taxpayer, up to a maximum of 2 weeks. For example, the maximum short, temporary absence period of a taxpayer with a 1-week pay period would be 4 days. The final regulations do not adopt this comment, which would result in disparate treatment of taxpayers based on length of pay period.

A commentator suggested that the final regulations should adopt 12 weeks as a temporary absence safe harbor. The commentator based this suggestion on the Family Medical Leave Act (FMLA), which guarantees workers a maximum of 12 weeks of unpaid leave for the birth or adoption of a child and other purposes. The final regulations do not adopt this comment. Different policies underlie the FMLA and the dependent care credit. An absence of 12 weeks is not a short, temporary absence for purposes of claiming the credit.

The final regulations include a safe harbor that treats an absence of no more than 2 consecutive calendar weeks as a short, temporary absence, and modify the examples to illustrate this rule.

b. Other Costs

A commentator suggested that the final regulations should clarify that expenses may be paid to enable a taxpayer to be gainfully employed and may be employment-related expenses if one parent works during the day and the other parent works at night, and the expenses are for care while one parent is working and the other is sleeping. Another commentator suggested that the cost of overnight care (not overnight camp) should be an employment-related expense for a taxpayer who works at night. The final regulations include examples illustrating that expenses may be employment-related expenses in these situations.

Commentators suggested that the cost of care should be treated as an employment-related expense for any period that a taxpayer is on short-or long-term disability, leave under the FMLA, paid medical leave, or paid maternity leave. The final regulations do not adopt these comments as these rules would be inconsistent with the statutory requirement that expenses are employment-related expenses only if paid to enable the taxpayer to be gainfully employed.

4. Limitations on Amount Creditable

a. Dollar Limit

Commentators suggested that the dollar limit on employment-related expenses should be increased from $3,000 for one qualifying child and $6,000 for two or more qualifying children, to $5,000 for each qualifying child. The final regulations do not adopt these comments as they are inconsistent with the statutory limitations.

b. Student at an Educational Organization

For purposes of the deemed earned income of a spouse who is a full-time student, section 21(e)(7) and (8) defines *student* as an individual who, during each of 5 calendar months during the taxable year, is a full-time student at an educational organization described in section 170(b)(1)(A)(ii). Section 170(b)(1)(A)(ii) provides that an educational organization normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

A commentator suggested that a full-time student in an on-line degree program is a full-time student at an educational organization. The final regulations do not adopt this comment. A degree program offered by an organization that provides instruction exclusively over the internet (as opposed to an organization that provides courses on-line as well as traditional classroom instruction) does not have students in attendance at the place where its educational activities are regularly carried on and is not an educational organization within the meaning of section 170(b)(1)(A)(ii). Accordingly, an individual enrolled in a program provided by an organization that offers only on-line instruction is not a student for purposes of the deemed earned income rule. However, an individual who takes on-line courses at an organization that has traditional classroom instruction as well as on-line courses, and that otherwise meets the definition of educational organization under section 170(b)(1)(A)(ii), may be a student for purposes of the deemed earned income rule.

The final regulations delete the cross-reference in the proposed regulations to the definition of student in section 152(f)(2) (for taxable years beginning after December 31, 2004) or section 151(c)(4) (for taxable years beginning before January 1, 2005), and the regulations thereunder, as that term is

defined in section 21(e)(7) and (8) and these regulations.

5. Substantiation

The proposed regulations provide that taxpayers claiming a credit for employment-related expenses must maintain adequate records or other sufficient evidence to substantiate the expenses in accordance with section 6001 and the regulations thereunder.

A commentator suggested that dependent care assistance program administrators should be able to rely on the representations of plan participants, without additional documentation, to establish that indirect expenses are required and are subject to forfeiture, the proper expense allocation for part-time employees, and whether expenses are paid on a weekly or monthly basis. The final regulations do not adopt this comment as these situations do not present unusual substantiation issues.

6. Conforming Changes

The final regulations incorporate several changes to conform to amendments to the statute. The final regulations reflect that the special dependency rule of section 21(e)(5) applies to children of parents who live apart at all times during the last 6 months of the calendar year as well as to the children of separated or divorced parents. The final regulations reflect the changes made to the definitions of *qualifying individual* and *custodial parent* by the Gulf Opportunity Zone Act of 2005 (Pub. L. 109–135, 119 Stat. 2577). Finally, the final regulations clarify that, for taxable years beginning after December 31, 2004, costs for care outside the taxpayer's household of a qualifying individual who is a dependent or spouse incapable of self-care who regularly spends at least 8 hours each day in the taxpayer's household may continue to qualify for the credit.

7. Effective Date

The final regulations apply to taxable years ending after August 14, 2007.

Effect on Other Documents

Rev. Rul. 76–278 (1976–2 CB 84) and Rev. Rul. 76–288 (1976–2 CB 83) are obsoleted as of August 14, 2007.

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. Section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final 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 Amy Pfalzgraf of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Department of the Treasury 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 I—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

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

Section 1.21–1 also issued under 26 U.S.C. 21(f).

Section 1.21–2 also issued under 26 U.S.C. 21(f).

Section 1.21–3 also issued under 26 U.S.C. 21(f).

Section 1.21–4 also issued under 26 U.S.C. 21(f) * * *

§ 1.21–1 [Redesignated as § 1.15–1].

■ **Par. 2.** Section 1.21–1 is redesignated § 1.15–1.

■ **Par. 3.** New §§ 1.21–1, 1.21–2, 1.21–3, and 1.21–4 are added to read as follows:

§ 1.21–1 Expenses for household and dependent care services necessary for gainful employment.

(a) *In general.* (1) Section 21 allows a credit to a taxpayer against the tax imposed by chapter 1 for employment-related expenses for household services and care (as defined in paragraph (d) of this section) of a qualifying individual (as defined in paragraph (b) of this section). The purpose of the expenses must be to enable the taxpayer to be gainfully employed (as defined in paragraph (c) of this section). For taxable years beginning after December 31, 2004, a qualifying individual must have the same principal place of abode (as defined in paragraph (g) of this section) as the taxpayer for more than one-half of the taxable year. For taxable years beginning before January 1, 2005, the taxpayer must maintain a household (as defined in paragraph (h) of this section) that includes one or more qualifying individuals.

(2) The amount of the credit is equal to the applicable percentage of the employment-related expenses that may be taken into account by the taxpayer during the taxable year (but subject to the limits prescribed in § 1.21–2). *Applicable percentage* means 35 percent reduced by 1 percentage point for each $2,000 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds $15,000, but not less than 20 percent. For example, if a taxpayer's adjusted gross income is $31,850, the applicable percentage is 26 percent.

(3) Expenses may be taken as a credit under section 21, regardless of the taxpayer's method of accounting, only in the taxable year the services are performed or the taxable year the expenses are paid, whichever is later.

(4) The requirements of section 21 and §§ 1.21–1 through 1.21–4 are applied at the time the services are performed, regardless of when the expenses are paid.

(5) *Examples.* The provisions of this paragraph (a) are illustrated by the following examples.

Example 1. In December 2007, B pays for the care of her child for January 2008. Under paragraph (a)(3) of this section, B may claim the credit in 2008, the later of the years in which the expenses are paid and the services are performed.

Example 2. The facts are the same as in *Example 1*, except that B's child turns 13 on February 1, 2008, and B pays for the care provided in January 2008 on February 3, 2008. Under paragraph (a)(4) of this section, the determination of whether the expenses are employment-related expenses is made when the services are performed. Assuming other requirements are met, the amount B pays will be an employment-related expense under section 21, because B's child is a qualifying individual when the services are performed, even though the child is not a qualifying individual when B pays the expenses.

(b) *Qualifying individual*—(1) *In general.* For taxable years beginning after December 31, 2004, a qualifying individual is—

(i) The taxpayer's dependent (who is a qualifying child within the meaning of section 152) who has not attained age 13;

(ii) The taxpayer's dependent (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B)) who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year; or

(iii) The taxpayer's spouse who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year.

(2) *Taxable years beginning before January 1, 2005.* For taxable years beginning before January 1, 2005, a qualifying individual is—

(i) The taxpayer's dependent for whom the taxpayer is entitled to a deduction for a personal exemption under section 151(c) and who is under age 13;

(ii) The taxpayer's dependent who is physically or mentally incapable of self-care; or

(iii) The taxpayer's spouse who is physically or mentally incapable of self-care.

(3) *Qualification on a daily basis.* The status of an individual as a qualifying individual is determined on a daily basis. An individual is not a qualifying individual on the day the status terminates.

(4) *Physical or mental incapacity.* An individual is physically or mentally incapable of self-care if, as a result of a physical or mental defect, the individual is incapable of caring for the individual's hygiene or nutritional needs, or requires full-time attention of another person for the individual's own safety or the safety of others. The inability of an individual to engage in any substantial gainful activity or to perform the normal household functions of a homemaker or care for minor children by reason of a physical or mental condition does not of itself establish that the individual is physically or mentally incapable of self-care.

(5) *Special test for divorced or separated parents or parents living apart*—(i) Scope. This paragraph (b)(5) applies to a child (as defined in section 152(f)(1) for taxable years beginning after December 31, 2004, and in section 151(c)(3) for taxable years beginning before January 1, 2005) who—

(A) Is under age 13 or is physically or mentally incapable of self-care;

(B) Receives over one-half of his or her support during the calendar year from one or both parents who are divorced or legally separated under a decree of divorce or separate maintenance, are separated under a written separation agreement, or live apart at all times during the last 6 months of the calendar year; and

(C) Is in the custody of one or both parents for more than one-half of the calendar year.

(ii) *Custodial parent allowed the credit.* A child to whom this paragraph (b)(5) applies is the qualifying individual of only one parent in any taxable year and is the qualifying child of the custodial parent even if the noncustodial parent may claim the dependency exemption for that child for that taxable year. See section 21(e)(5). The custodial parent is the parent having custody for the greater portion of the calendar year. See section 152(e)(4)(A).

(6) *Example.* The provisions of this paragraph (b) are illustrated by the following example.

Example. C pays $420 for the care of her child, a qualifying individual, to be provided from January 2 through January 31, 2008 (21 days of care). On January 20, 2008, C's child turns 13 years old. Under paragraph (b)(3) of this section, C's child is a qualifying individual from January 2 through January 19, 2008 (13 days of care). C may take into account $260, the pro rata amount C pays for the care of her child for 13 days, under section 21. See § 1.21–2(a)(4).

(c) *Gainful employment*—(1) *In general.* Expenses are employment-related expenses only if they are for the purpose of enabling the taxpayer to be gainfully employed. The expenses must be for the care of a qualifying individual or household services performed during periods in which the taxpayer is gainfully employed or is in active search of gainful employment. Employment may consist of service within or outside the taxpayer's home and includes self-employment. An expense is not employment-related merely because it is paid or incurred while the taxpayer is gainfully employed. The purpose of the expense must be to enable the taxpayer to be gainfully employed. Whether the purpose of an expense is to enable the taxpayer to be gainfully employed depends on the facts and circumstances of the particular case. Work as a volunteer or for a nominal consideration is not gainful employment.

(2) *Determination of period of employment on a daily basis*—(i) *In general.* Expenses paid for a period during only part of which the taxpayer is gainfully employed or in active search of gainful employment must be allocated on a daily basis.

(ii) *Exception for short, temporary absences.* A taxpayer who is gainfully employed is not required to allocate expenses during a short, temporary absence from work, such as for vacation or minor illness, provided that the care-giving arrangement requires the taxpayer to pay for care during the absence. An absence of 2 consecutive calendar weeks is a short, temporary absence. Whether an absence longer than 2 consecutive calendar weeks is a short, temporary absence is determined based on all the facts and circumstances.

(iii) *Part-time employment.* A taxpayer who is employed part-time generally must allocate expenses for dependent care between days worked and days not worked. However, if a taxpayer employed part-time is required to pay for dependent care on a periodic basis (such as weekly or monthly) that includes both days worked and days not worked, the taxpayer is not required to allocate the expenses. A day on which the taxpayer works at least 1 hour is a day of work.

(3) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples:

Example 1. D works during the day and her husband, E, works at night and sleeps during the day. D and E pay for care for a qualifying individual during the hours when D is working and E is sleeping. Under paragraph (c)(1) of this section, the amount paid by D and E for care may be for the purpose of allowing D and E to be gainfully employed and may be an employment-related expense under section 21.

Example 2. F works at night and pays for care for a qualifying individual during the hours when F is working. Under paragraph (c)(1) of this section, the amount paid by F for care may be for the purpose of allowing F to be gainfully employed and may be an employment-related expense under section 21.

Example 3. G, the custodial parent of two children who are qualifying individuals, hires a housekeeper for a monthly salary to care for the children while G is gainfully employed. G becomes ill and as a result is absent from work for 4 months. G continues to pay the housekeeper to care for the children while G is absent from work. During this 4-month period, G performs no employment services, but receives payments under her employer's wage continuation plan. Although G may be considered to be gainfully employed during her absence from work, the absence is not a short, temporary absence within the meaning of paragraph (c)(2)(ii) of this section, and her payments for household and dependent care services during the period of illness are not for the purpose of enabling her to be gainfully employed. G's expenses are not employment-related expenses, and she may not take the expenses into account under section 21.

Example 4. To be gainfully employed, H sends his child to a dependent care center that complies with all state and local requirements. The dependent care center requires payment for days when a child is absent from the center. H takes 8 days off from work as vacation days. Because the absence is less than 2 consecutive calendar

weeks, under paragraph (c)(2)(ii) of this section, H's absence is a short, temporary absence. H is not required to allocate expenses between days worked and days not worked. The entire fee for the period that includes the 8 vacation days may be an employment-related expense under section 21.

Example 5. J works 3 days per week and her child attends a dependent care center (that complies with all state and local requirements) to enable her to be gainfully employed. The dependent care center allows payment for any 3 days per week for $150 or 5 days per week for $250. J enrolls her child for 5 days per week, and her child attends the care center for 5 days per week. Under paragraph (c)(2)(iii) of this section, J must allocate her expenses for dependent care between days worked and days not worked. Three-fifths of the $250, or $150 per week, may be an employment-related expense under section 21.

Example 6. The facts are the same as in *Example 5,* except that the dependent care center does not offer a 3-day option. The entire $250 weekly fee may be an employment-related expense under section 21.

(d) *Care of qualifying individual and household services*—(1) *In general.* To qualify for the dependent care credit, expenses must be for the care of a qualifying individual. Expenses are for the care of a qualifying individual if the primary function is to assure the individual's well-being and protection. Not all expenses relating to a qualifying individual are for the individual's care. Amounts paid for food, lodging, clothing, or education are not for the care of a qualifying individual. If, however, the care is provided in such a manner that the expenses cover other goods or services that are incidental to and inseparably a part of the care, the full amount is for care.

(2) *Allocation of expenses.* If an expense is partly for household services or for the care of a qualifying individual and partly for other goods or services, a reasonable allocation must be made. Only so much of the expense that is allocable to the household services or care of a qualifying individual is an employment-related expense. An allocation must be made if a housekeeper or other domestic employee performs household duties and cares for the qualifying children of the taxpayer and also performs other services for the taxpayer. No allocation is required, however, if the expense for the other purpose is minimal or insignificant or if an expense is partly attributable to the care of a qualifying individual and partly to household services.

(3) *Household services.* Expenses for household services may be employment-related expenses if the services are performed in connection with the care of a qualifying individual. The household services must be the performance in and about the taxpayer's home of ordinary and usual services necessary to the maintenance of the household and attributable to the care of the qualifying individual. Services of a housekeeper are household services within the meaning of this paragraph (d)(3) if the services are provided, at least in part, to the qualifying individual. Such services as are performed by chauffeurs, bartenders, or gardeners are not household services.

(4) *Manner of providing care.* The manner of providing care need not be the least expensive alternative available to the taxpayer. The cost of a paid caregiver may be an expense for the care of a qualifying individual even if another caregiver is available at no cost.

(5) *School or similar program.* Expenses for a child in nursery school, pre-school, or similar programs for children below the level of kindergarten are for the care of a qualifying individual and may be employment-related expenses. Expenses for a child in kindergarten or a higher grade are not for the care of a qualifying individual. However, expenses for before- or after-school care of a child in kindergarten or a higher grade may be for the care of a qualifying individual.

(6) *Overnight camps.* Expenses for overnight camps are not employment-related expenses.

(7) *Day camps.* (i) The cost of a day camp or similar program may be for the care of a qualifying individual and an employment-related expense, without allocation under paragraph (d)(2) of this section, even if the day camp specializes in a particular activity. Summer school and tutoring programs are not for the care of a qualifying individual and the costs are not employment-related expenses.

(ii) A day camp that meets the definition of *dependent care center* in section 21(b)(2)(D) and paragraph (e)(2) of this section must comply with the requirements of section 21(b)(2)(C) and paragraph (e)(2) of this section.

(8) *Transportation.* The cost of transportation by a dependent care provider of a qualifying individual to or from a place where care of that qualifying individual is provided may be for the care of the qualifying individual. The cost of transportation not provided by a dependent care provider is not for the care of the qualifying individual.

(9) *Employment taxes.* Taxes under sections 3111 (relating to the Federal Insurance Contributions Act) and 3301 (relating to the Federal Unemployment Tax Act) and similar state payroll taxes are employment-related expenses if paid in respect of wages that are employment-related expenses.

(10) *Room and board.* The additional cost of providing room and board for a caregiver over usual household expenditures may be an employment-related expense.

(11) *Indirect expenses.* Expenses that relate to, but are not directly for, the care of a qualifying individual, such as application fees, agency fees, and deposits, may be for the care of a qualifying individual and may be employment-related expenses if the taxpayer is required to pay the expenses to obtain the related care. However, forfeited deposits and other payments are not for the care of a qualifying individual if care is not provided.

(12) *Examples.* The provisions of this paragraph (d) are illustrated by the following examples:

Example 1. To be gainfully employed, K sends his 3-year old child to a pre-school. The pre-school provides lunch and snacks. Under paragraph (d)(1) of this section, K is not required to allocate expenses between care and the lunch and snacks, because the lunch and snacks are incidental to and inseparably a part of the care. Therefore, K may treat the full amount paid to the pre-school as for the care of his child.

Example 2. L, a member of the armed forces, is ordered to a combat zone. To be able to comply with the orders, L places her 10-year old child in boarding school. The school provides education, meals, and housing to L's child in addition to care. Under paragraph (d)(2) of this section, L must allocate the cost of the boarding school between expenses for care and expenses for education and other services not constituting care. Only the part of the cost of the boarding school that is for the care of L's child is an employment-related expense under section 21.

Example 3. To be gainfully employed, M employs a full-time housekeeper to care for M's two children, aged 9 and 13 years. The housekeeper regularly performs household services of cleaning and cooking and drives M to and from M's place of employment, a trip of 15 minutes each way. Under paragraph (d)(3) of this section, the chauffeur services are not household services. M is not required to allocate a portion of the expense of the housekeeper to the chauffeur services under paragraph (d)(2) of this section, however, because the chauffeur services are minimal and insignificant. Further, no allocation under paragraph (d)(2) of this section is required to determine the portion of the expenses attributable to the care of the 13-year old child (not a qualifying individual) because the household expenses are in part attributable to the care of the 9-year-old child. Accordingly, the entire expense of employing the housekeeper is an employment-related expense. The amount that M may take into account as an employment-related expense under section

21, however, is limited to the amount allowable for one qualifying individual.

Example 4. To be gainfully employed, N sends her 9-year-old child to a summer day camp that offers computer activities and recreational activities such as swimming and arts and crafts. Under paragraph (d)(7)(i) of this section, the full cost of the summer day camp may be for care.

Example 5. To be gainfully employed, O sends her 9-year-old child to a math tutoring program for two hours per day during the summer. Under paragraph (d)(7)(i) of this section, the cost of the tutoring program is not for care.

Example 6. To be gainfully employed, P hires a full-time housekeeper to care for her 8-year old child. In order to accommodate the housekeeper, P moves from a 2-bedroom apartment to a 3-bedroom apartment that otherwise is comparable to the 2-bedroom apartment. Under paragraph (d)(10) of this section, the additional cost to rent the 3-bedroom apartment over the cost of the 2-bedroom apartment and any additional utilities attributable to the housekeeper's residence in the household may be employment-related expenses under section 21.

Example 7. Q pays a fee to an agency to obtain the services of an au pair to care for Q's children, qualifying individuals, to enable Q to be gainfully employed. An au pair from the agency subsequently provides care for Q's children. Under paragraph (d)(11) of this section, the fee may be an employment-related expense.

Example 8. R places a deposit with a pre-school to reserve a place for her child. R sends the child to a different pre-school and forfeits the deposit. Under paragraph (d)(11) of this section, the forfeited deposit is not an employment-related expense.

(e) *Services outside the taxpayer's household*—(1) *In general.* The credit is allowable for expenses for services performed outside the taxpayer's household only if the care is for one or more qualifying individuals who are described in this section at—

(i) Paragraph (b)(1)(i) or (b)(2)(i); or

(ii) Paragraph (b)(1)(ii), (b)(2)(ii), (b)(1)(iii), or (b)(2)(iii) and regularly spend at least 8 hours each day in the taxpayer's household.

(2) *Dependent care centers*—(i) *In general.* The credit is allowable for services performed by a dependent care center only if—

(A) The center complies with all applicable laws and regulations, if any, of a state or local government, such as state or local licensing requirements and building and fire code regulations; and

(B) The requirements provided in this paragraph (e) are met.

(ii) *Definition.* The term *dependent care center* means any facility that provides full-time or part-time care for more than six individuals (other than individuals who reside at the facility) on a regular basis during the taxpayer's taxable year, and receives a fee, payment, or grant for providing services for the individuals (regardless of whether the facility is operated for profit). For purposes of the preceding sentence, a facility is presumed to provide full-time or part-time care for six or fewer individuals on a regular basis during the taxpayer's taxable year if the facility has six or fewer individuals (including the taxpayer's qualifying individual) enrolled for full-time or part-time care on the day the qualifying individual is enrolled in the facility (or on the first day of the taxable year the qualifying individual attends the facility if the qualifying individual was enrolled in the facility in the preceding taxable year) unless the Internal Revenue Service demonstrates that the facility provides full-time or part-time care for more than six individuals on a regular basis during the taxpayer's taxable year.

(f) *Reimbursed expenses.* Employment-related expenses for which the taxpayer is reimbursed (for example, under a dependent care assistance program) may not be taken into account for purposes of the credit.

(g) *Principal place of abode.* For purposes of this section, the term *principal place of abode* has the same meaning as in section 152.

(h) *Maintenance of a household*—(1) *In general.* For taxable years beginning before January 1, 2005, the credit is available only to a taxpayer who maintains a household that includes one or more qualifying individuals. A taxpayer maintains a household for the taxable year (or lesser period) only if the taxpayer (and spouse, if applicable) occupies the household and furnishes over one-half of the cost for the taxable year (or lesser period) of maintaining the household. The household must be the principal place of abode for the taxable year of the taxpayer and the qualifying individual or individuals.

(2) *Cost of maintaining a household.* (i) Except as provided in paragraph (h)(2)(ii) of this section, for purposes of this section, the term *cost of maintaining a household* has the same meaning as in § 1.2–2(d) without regard to the last sentence thereof.

(ii) The cost of maintaining a household does not include the value of services performed in the household by the taxpayer or by a qualifying individual described in paragraph (b) of this section or any expense paid or reimbursed by another person.

(3) *Monthly proration of annual costs.* In determining the cost of maintaining a household for a period of less than a taxable year, the cost for the entire taxable year must be prorated on the basis of the number of calendar months within that period. A period of less than a calendar month is treated as a full calendar month.

(4) *Two or more families.* If two or more families occupy living quarters in common, each of the families is treated as maintaining a separate household. A taxpayer is maintaining a household if the taxpayer provides more than one-half of the cost of maintaining the separate household. For example, if two unrelated taxpayers with their respective children occupy living quarters in common and each taxpayer pays more than one-half of the household costs for each respective family, each taxpayer is treated as maintaining a household.

(i) Reserved.

(j) *Expenses qualifying as medical expenses*—(1) *In general.* A taxpayer may not take an amount into account as both an employment-related expense under section 21 and an expense for medical care under section 213.

(2) *Examples.* The provisions of this paragraph (j) are illustrated by the following examples:

Example 1. S has $6,500 of employment-related expenses for the care of his child who is physically incapable of self-care. The expenses are for services performed in S's household that also qualify as expenses for medical care under section 213. Of the total expenses, S may take into account $3,000 under section 21. S may deduct the balance of the expenses, or $3,500, as expenses for medical care under section 213 to the extent the expenses exceed 7.5 percent of S's adjusted gross income.

Example 2. The facts are the same as in *Example 1,* however, S first takes into account the $6,500 of expenses under section 213. S deducts $500 as an expense for medical care, which is the amount by which the expenses exceed 7.5 percent of his adjusted gross income. S may not take into account the $6,000 balance as employment-related expenses under section 21, because he has taken the full amount of the expenses into account in computing the amount deductible under section 213.

(k) *Substantiation.* A taxpayer claiming a credit for employment-related expenses must maintain adequate records or other sufficient evidence to substantiate the expenses in accordance with section 6001 and the regulations thereunder.

(l) *Effective/applicability date.* This section and §§ 1.21–2 through 1.21–4 apply to taxable years ending after August 14, 2007.

§ 1.21–2 Limitations on amount creditable.

(a) *Annual dollar limitation.* (1) The amount of employment-related expenses that may be taken into account under § 1.21–1(a) for any taxable year cannot exceed—

(i) $2,400 ($3,000 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there is one qualifying individual with respect to the taxpayer at any time during the taxable year; or

(ii) $4,800 ($6,000 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there are two or more qualifying individuals with respect to the taxpayer at any time during the taxable year.

(2) The amount determined under paragraph (a)(1) of this section is reduced by the aggregate amount excludable from gross income under section 129 for the taxable year.

(3) A taxpayer may take into account the total amount of employment-related expenses that do not exceed the annual dollar limitation although the amount of employment-related expenses attributable to one qualifying individual is disproportionate to the total employment-related expenses. For example, a taxpayer with expenses in 2007 of $4,000 for one qualifying individual and $1,500 for a second qualifying individual may take into account the full $5,500.

(4) A taxpayer is not required to prorate the annual dollar limitation if a qualifying individual ceases to qualify (for example, by turning age 13) during the taxable year. However, the taxpayer may take into account only amounts that qualify as employment-related expenses before the disqualifying event. See also § 1.21–1(b)(6).

(b) *Earned income limitation*—(1) *In general.* The amount of employment-related expenses that may be taken into account under section 21 for any taxable year cannot exceed—

(i) For a taxpayer who is not married at the close of the taxable year, the taxpayer's earned income for the taxable year; or

(ii) For a taxpayer who is married at the close of the taxable year, the lesser of the taxpayer's earned income or the earned income of the taxpayer's spouse for the taxable year.

(2) *Determination of spouse.* For purposes of this paragraph (b), a taxpayer must take into account only the earned income of a spouse to whom the taxpayer is married at the close of the taxable year. The spouse's earned income for the entire taxable year is taken into account, however, even though the taxpayer and the spouse were married for only part of the taxable year. The taxpayer is not required to take into account the earned income of a spouse who died or was divorced or separated from the taxpayer during the taxable year. See § 1.21–3(b) for rules providing that certain married taxpayers legally separated or living apart are treated as not married.

(3) *Definition of earned income.* For purposes of this section, the term *earned income* has the same meaning as in section 32(c)(2) and the regulations thereunder.

(4) *Attribution of earned income to student or incapacitated spouse.* (i) For purposes of this section, a spouse is deemed, for each month during which the spouse is a full-time student or is a qualifying individual described in § 1.21–1(b)(1)(iii) or (b)(2)(iii), to be gainfully employed and to have earned income of not less than—

(A) $200 ($250 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there is one qualifying individual with respect to the taxpayer at any time during the taxable year; or

(B) $400 ($500 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there are two or more qualifying individuals with respect to the taxpayer at any time during the taxable year.

(ii) For purposes of this paragraph (b)(4), a full-time student is an individual who, during each of 5 calendar months of the taxpayer's taxable year, is enrolled as a student for the number of course hours considered to be a full-time course of study at an educational organization as defined in section 170(b)(1)(A)(ii). The enrollment for 5 calendar months need not be consecutive.

(iii) Earned income may be attributed under this paragraph (b)(4), in the case of any husband and wife, to only one spouse in any month.

(c) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. In 2007, T, who is married to U, pays employment-related expenses of $5,000 for the care of one qualifying individual. T's earned income for the taxable year is $40,000 and her husband's earned income is $2,000. T did not exclude any dependent care assistance under section 129. Under paragraph (b)(1) of this section, T may take into account under section 21 only the amount of employment-related expenses that does not exceed the lesser of her earned income or the earned income of U, or $2,000.

Example 2. The facts are the same as in *Example 1* except that U is a full-time student at an educational organization within the meaning of section 170(b)(1)(A)(ii) for 9 months of the taxable year and has no earned income. Under paragraph (b)(4) of this section, U is deemed to have earned income of $2,250. T may take into account $2,250 of employment-related expenses under section 21.

Example 3. For all of 2007, V is a full-time student and W, V's husband, is an individual who is incapable of self-care (as defined in § 1.21–1(b)(1)(iii)). V and W have no earned income and pay expenses of $5,000 for W's care. Under paragraph (b)(4) of this section, either V or W may be deemed to have $3,000 of earned income. However, earned income may be attributed to only one spouse under paragraph (b)(4)(iii) of this section. Under the limitation in paragraph (b)(1)(ii) of this section, the lesser of V's and W's earned income is zero. V and W may not take the expenses into account under section 21.

(d) *Cross-reference.* For an additional limitation on the credit under section 21, see section 26.

§ 1.21–3 Special rules applicable to married taxpayers.

(a) *Joint return requirement.* No credit is allowed under section 21 for taxpayers who are married (within the meaning of section 7703 and the regulations thereunder) at the close of the taxable year unless the taxpayer and spouse file a joint return for the taxable year. See section 6013 and the regulations thereunder relating to joint returns of income tax by husband and wife.

(b) *Taxpayers treated as not married.* The requirements of paragraph (a) of this section do not apply to a taxpayer who is legally separated under a decree of divorce or separate maintenance or who is treated as not married under section 7703(b) and the regulations thereunder (relating to certain married taxpayers living apart). A taxpayer who is treated as not married under this paragraph (b) is not required to take into account the earned income of the taxpayer's spouse for purposes of applying the earned income limitation on the amount of employment-related expenses under § 1.21–2(b).

(c) *Death of married taxpayer.* If a married taxpayer dies during the taxable year and the survivor may make a joint return with respect to the deceased spouse under section 6013(a)(3), the credit is allowed for the year only if a joint return is made. If, however, the surviving spouse remarries before the end of the taxable year in which the deceased spouse dies, a credit may be allowed on the decedent spouse(s separate return.

§ 1.21–4 Payments to certain related individuals.

(a) *In general.* A credit is not allowed under section 21 for any amount paid by the taxpayer to an individual—

(1) For whom a deduction under section 151(c) (relating to deductions for personal exemptions for dependents) is allowable either to the taxpayer or the taxpayer's spouse for the taxable year;

(2) Who is a child of the taxpayer (within the meaning of section 152(f)(1) for taxable years beginning after

December 31, 2004, and section 151(c)(3) for taxable years beginning before January 1, 2005) and is under age 19 at the close of the taxable year;

(3) Who is the spouse of the taxpayer at any time during the taxable year; or

(4) Who is the parent of the taxpayer's child who is a qualifying individual described in § 1.21–1(b)(1)(i) or (b)(2)(i).

(b) *Payments to partnerships or other entities.* In general, paragraph (a) of this section does not apply to services performed by partnerships or other entities. If, however, the partnership or other entity is established or maintained primarily to avoid the application of paragraph (a) of this section to permit the taxpayer to claim the credit, for purposes of section 21, the payments of employment-related expenses are treated as made directly to each partner or owner in proportion to that partner's or owner's ownership interest. Whether a partnership or other entity is established or maintained to avoid the application of paragraph (a) of this section is determined based on the facts and circumstances, including whether the partnership or other entity is established for the primary purpose of caring for the taxpayer's qualifying individual or providing household services to the taxpayer.

(c) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. During 2007, X pays $5,000 to her mother for the care of X's 5-year old child who is a qualifying individual. The expenses otherwise qualify as employment-related expenses. X's mother is not her dependent. X may take into account under section 21 the amounts paid to her mother for the care of X's child.

Example 2. Y is divorced and has custody of his 5-year old child, who is a qualifying individual. Y pays $6,000 during 2007 to Z, who is his ex-wife and the child's mother, for the care of the child. The expenses otherwise qualify as employment-related expenses. Under paragraph (a)(4) of this section, Y may not take into account under section 21 the amounts paid to Z because Z is the child's mother.

Example 3. The facts are the same as in Example 2, except that Z is not the mother of Y's child. Y may take into account under section 21 the amounts paid to Z.

§§ 1.44A–1 through 1.44A–4 [Removed]

■ **Par. 4.** Sections 1.44A–1, 1.44A–2, 1.44A–3, and 1.44A–4 are removed.

§ 1.214–1 [Removed]

■ **Par. 5.** Section 1.214–1 is removed.

§§ 1.214A–1 through 1.214A–5 [Removed]

■ **Par. 6.** Sections 1.214A–1, 1.214A–2, 1.214A–3, 1.214A–4, and 1.214A–5 are removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 7.** The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

■ **Par. 8.** In § 602.101, paragraph (b) is amended to remove entries 1.44A–1 and 1.44A–3.

Kevin M. Brown,

Deputy Commissioner for Services and Enforcement.

Approved: August 2, 2007.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. E7–15753 Filed 8–13–07; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9353]

RIN 1545–BC67

Section 1045 Application to Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the application of section 1045 of the Internal Revenue Code (Code) to partnerships and their partners. These regulations provide rules regarding the deferral of gain on a partnership's sale of qualified small business stock (QSB stock) and a partner's sale of QSB stock distributed by a partnership. These regulations also provide rules for a taxpayer (other than a C corporation) who sells QSB stock and purchases replacement QSB stock through a partnership. The regulations affect partnerships that invest in QSB stock and their partners.

DATES: *Effective Date:* These regulations are effective August 14, 2007.

Applicability Dates: For dates of applicability of these regulations, see § 1.1045–1(j).

FOR FURTHER INFORMATION CONTACT: Jian H. Grant at (202) 622–3050 (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(d)) under control number 1545–1893. Responses to these collections of information are mandatory and are required to obtain a benefit. The collections of information in these final regulations are in § 1.1045–1(b)(3)(ii)(C), (b)(5)(ii), and (c)(4)(ii). The information collected in § 1.1045–1(b)(5)(ii) is required to ensure that gain from the sale of QSB stock by a partnership is reported correctly. The information collected in § 1.1045–1(b)(3)(ii)(C) and (c)(4)(ii) will be used by the partnership and the partner to make the basis adjustments upon the sale of QSB stock and the purchase of replacement QSB stock when necessary. The likely respondents are businesses or other for-profit institutions and small businesses or organizations.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Estimated total annual reporting burden: 1,500 hours.

The estimated annual burden per respondent varies from 45 to 75 minutes, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of respondents: 1,500.

Estimated annual frequency of responses: On occasion.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP 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 these collections of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

Background

This document amends 26 CFR part 1 under section 1045 of the Code by adding § 1.1045–1 regarding the application of section 1045 to partnerships and their partners.

Section 1045 permits a non-corporate taxpayer that holds QSB stock for more than six months and sells it after August