(vi) *Election to defer application of special effective date.* A consolidated group may elect not to apply paragraph (b)(1)(v) of this section to consolidated return years beginning before January 1, 1998. To make this election, a consolidated group must write ''Election Pursuant to Notice 98–40'' across the top of page 1 of an original or amended tax return for each consolidated return year subject to the election. For the first consolidated return year to which the overall foreign loss provisions of paragraph (b)(1)(v) of this section apply (i.e., the first year beginning on or after January 1, 1998), such consolidated group must write ''Notice 98–40 Election in Effect in Prior Years'' across the top of page 1 of the consolidated tax return for that year. For purposes of applying § 1.1502–9(b)(1)(ii) with respect to such year, any member with a balance in an overall foreign loss account from a separate return limitation year on the first day of such year shall be treated as joining the group on such first day.

* * * * *

Approved: December 7, 1998.

Robert L. Wenzel,

Deputy Commissioner of Internal Revenue.

Donald C. Lubick,

Assistant Secretary of the Treasury.

[FR Doc. 98–33702 Filed 12–28–98; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 8802]

RIN 1545–AN21

Certain Asset Transfers to a Tax-Exempt Entity

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that implement provisions of the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988. The final regulations generally affect a taxable corporation that transfers all or substantially all of its assets to a tax-exempt entity or converts from a taxable corporation to a tax-exempt entity in a transaction other than a liquidation, and generally require the taxable corporation to recognize gain or loss as if it had sold the assets transferred at fair market value.

DATES: *Effective Date:* These regulations are effective January 28, 1999.

Applicability Date: For dates of applicability of these regulations, see § 1.337(d)-4(e).

FOR FURTHER INFORMATION CONTACT: Stephen R. Cleary, (202) 622–7530 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in these final regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1633.

The collection of information in this regulation is described in § 1.337(d)-4(b)(1)(i). The information is a written representation made by a tax-exempt entity estimating the percentage it will use assets formerly held by a taxable corporation in an activity the income from which is subject to tax under section 511(a), as opposed to other activities. The information may be used by the taxable corporation in computing the amount of gain or loss that is recognized under the regulations. The information may also be used by the IRS in determining whether the proper amount of tax is due on the transaction. The collection of information is not mandatory but will enable the taxable corporation to support its reporting of the tax consequences of the transaction. The likely respondents are tax-exempt entities subject to the unrelated business income tax under section 511(a) (including most organizations that are exempt from tax under section 501, state colleges and universities, and certain charitable trusts).

Comments concerning the collection 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, Attention: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Any such comments should be submitted not later than March 1, 1999.

Comments are specifically requested concerning:

(a) Whether the collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

(b) The accuracy of the estimated burden associated with the collection of information (see below);

(c) How the quality, utility, and clarity of the information requested may be enhanced;

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

(e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Estimated total annual reporting burden: 125 hours. The annual burden per respondent varies from 1 hour to 10 hours, depending on individual circumstances, with an estimated average of 5 hours.

Estimated number of respondents: 25.

Estimated frequency of responses: Once.

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 OMB.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

Background

On January 15, 1997, proposed regulations § 1.337(d)-4 were published in the **Federal Register** (62 FR 2064, [REG–209121–89, 1997–1 C.B. 719]). The regulations were proposed to amend 26 CFR part 1 and were intended to carry out the purposes of the repeal of the *General Utilities* doctrine (''*General Utilities* repeal'') as enacted in the Tax Reform Act of 1986 (the ''1986 Act'').

The 1986 Act amended sections 336 and 337, generally requiring corporations to recognize gain or loss when appreciated or depreciated property is distributed in complete liquidation or is sold in connection with a complete liquidation. Section 337(d) directs the Secretary to prescribe regulations as may be necessary to carry out the purposes of *General Utilities* repeal, including rules to ''ensure that these purposes shall not be circumvented * * * through the use of a * * * tax-exempt entity.''

The legislative history concerning a 1988 amendment to section 337(d) explains:

> The bill also clarifies in connection with the built-in gain provisions of the Act that the Treasury Department shall prescribe such regulations as may be necessary or appropriate to carry out those provisions * * * . For example, this includes rules to

require the recognition of gain if appreciated property of a C corporation is transferred to a * * * tax-exempt entity [footnote 32] in a carryover basis transaction that would otherwise eliminate corporate level tax on the built-in appreciation.

[footnote 32] The Act generally requires recognition of gain if a C corporation transfers appreciated assets to a tax exempt entity in a section 332 liquidation. See Code section 337(b)(2).

S. Rep. No. 445, 100th Cong., 2d Sess. 66 (1988).

Explanation of Provision

A. The Proposed Rule

(1) A taxable corporation that transfers all or substantially all of its assets to one or more tax-exempt entities is required to recognize gain or loss as if the assets transferred were sold at their fair market values (§ 1.337(d)-4(a)(1), Asset Sale Rule);

(2) A taxable corporation that changes its status to a tax-exempt entity generally is treated as having transferred all of its assets to a tax-exempt entity immediately before the change in status becomes effective in a transaction governed by the Asset Sale Rule (§ 1.337(d)-4(a)(2), Change in Status Rule);

(3) The Change in Status Rule does not apply (subject to application of the anti-abuse rule) if the corporation formerly was tax-exempt and the change in status is within three years of the later of (a) the corporation first filing a return as a taxable corporation, or (b) a final determination that the corporation had become a taxable corporation (§ 1.337(d)-4(a)(3), 3-Year Rule);

(4) The Asset Sale Rule does not apply if the transferred assets are used by the tax-exempt entity in an activity the income from which is subject to the unrelated business tax under section 511(a); notwithstanding any other provision of law, gain on such assets will later be included in unrelated business taxable income when the tax-exempt entity disposes of the assets or ceases to use the assets in an activity the income from which is subject to tax under section 511(a) (§ 1.337(d)-4(b)(1), UBTI Rule);

(5) The regulations apply to transfers of assets occurring after January 28, 1999, unless the transfer is pursuant to a written agreement which is (subject to customary conditions) binding on or before that date (§ 1.337(d)-4(e), Effective Date Rule).

The IRS and Treasury Department received approximately 32 written comments on the proposed regulations. In addition, the IRS held a public hearing on the proposed regulations on May 6, 1997. After consideration of all the written and oral comments, the IRS and Treasury Department are adopting the proposed regulations as revised by this Treasury Decision. The comments and changes to the regulations made in response to the comments are summarized below.

B. Comments and Changes in Response to Comments

1. Asset Sale Rule

Some commentators questioned whether section 337(d) authorizes taxation of asset transfers other than liquidations. Section 337(d) authorizes regulations to prevent circumvention of *General Utilities* repeal through the ''use of'' any provision of law or regulations (specifically including the corporate reorganization rules in Part III of Subchapter C). The statutory rules in sections 336 and 337(b)(2), enacted as part of *General Utilities* repeal, provide for corporate-level gain or loss recognition when a taxable corporation liquidates into a controlling tax-exempt entity. The regulations published in this Treasury Decision are intended to reach transactions that are economically similar to those liquidations but take different forms, such as a taxable corporation's transfer of substantially all of its assets to a tax-exempt entity or a taxable corporation's change in status resulting in its becoming a tax-exempt entity. The IRS and Treasury Department believe that section 337(d) provides clear authority for these regulations.

Some commentators questioned whether section 337(d) authorizes regulations that would tax transfers of assets without consideration, noting that making a gift generally does not cause the recognition of gain to the donor. Other commentators claimed that the proposed regulations, to the extent they apply to transfers of assets to charitable organizations, conflict with the policy of the charitable contribution deduction under section 170. The regulations do not affect the tax treatment of a corporation's gift of a portion of its assets to charity, nor do they affect the shareholders' tax treatment when transferring all or any part of the corporation's assets to charity by transferring all or any part of the corporation's stock to charity. The regulations apply only to transfers of all or substantially all of the assets of a taxable corporation to a tax-exempt entity or a taxable corporation's conversion to a tax-exempt entity. If shareholders donate all of a corporation's stock to a charity and the charity then liquidates the corporation, section 337(b)(2) taxes the liquidating corporation's gain. The final regulations, which remain unchanged from the proposed regulations in this respect, tax a taxable corporation's gain in other transactions that have the same economic effect.

One commentator proposed that the final regulations allow deferral of gain recognition on any asset transferred to a tax-exempt entity until the entity disposes of the asset. The commentator suggests a rule similar to that of section 1374, which provides generally that a C corporation that converts to being an S corporation is subject to tax if it disposes of assets held at the time of conversion during the ten-year period after the conversion. Under this rule, the tax-exempt entity would not be taxed on the built-in gain in assets that it retains. For the reasons stated above, the IRS and Treasury Department have concluded that the regulations generally should follow the rule in section 337(b)(2) rather than the rule contained in section 1374 to best accomplish the goal set forth in the statute and legislative history.

One commentator suggested that the Asset Sale Rule should not apply to a taxable corporation transferring assets to a tax-exempt entity in a like-kind exchange described in section 1031 or an involuntary conversion described in section 1033. In transactions described in these sections, the taxable corporation acquires replacement property that has a basis determined by reference to the basis of the property replaced. Because the built-in appreciation in the transferred asset is preserved in the replacement asset and remains in the hands of a taxable corporation, *General Utilities* repeal is not circumvented in these transactions. Accordingly, the final regulations exclude transactions from the Asset Sale Rule to the extent the transactions qualify for nonrecognition of gain or loss under section 1031 or 1033.

Some commentators proposed removing section 528 homeowners associations from the list of tax-exempt entities subject to the regulations because dispositions of assets by a homeowners association are subject to tax. Under section 528, homeowners associations are subject to tax on all of their income except for *exempt function income*, which is defined as fees, dues, or assessments from homeowners. Gains from the sale of a homeowners association's property are taxable; therefore, *General Utilities* repeal is not circumvented by transfers to homeowners associations. In addition, the properties that become the subject of section 528 homeowners associations generally are developed as business ventures, and the developer has substantial incentive to realize the increase in value of its assets in connection with their transfer to the association, thus providing additional protection with respect to *General Utilities* repeal. Also, a homeowners association may alternate between taxable and tax-exempt status because its exemption is based on a year-by-year election under section 528(c)(1)(E). In a given year, a homeowners association may prefer taxable status to tax-exempt status under section 528 because a section 528 organization is taxed at a 30 percent flat rate on income other than membership fees, dues, or assessments, while a taxable homeowners association is subject to tax on all income but at the progressive rates of section 11 (15 to 35 percent). The tax on non-exempt income under section 528 may exceed the tax the association would pay as a taxable corporation. Congress anticipated that these entities may alternate between taxable and tax-exempt status and that the assets of these entities will remain subject to tax on transfer. Imposing a tax on appreciated property each time such an entity converts its status could inhibit this flexibility. For this reason, and because *General Utilities* repeal will not be compromised, the IRS and Treasury Department believe that an organization's election to be treated under section 528 for a tax year should not trigger gain recognition. Accordingly, the final regulations do not treat section 528 homeowners associations as tax-exempt entities for purposes of section 337(d). For similar reasons, the final regulations do not define political organizations described in section 527 as tax-exempt entities for purposes of section 337(d).

Some commentators suggested that social clubs that are tax-exempt as organizations described in section 501(c)(7) should be removed from the list of tax-exempt entities for purposes of section 337(d). Commentators also suggested that tax-exempt social clubs be allowed to defer gain on transactions subject to the regulations, because social clubs may be subject to tax on gains from asset sales. Section 512(a)(3)(A) generally taxes the income of a section 501(c)(7) social club except for the social club's "exempt function income," as defined in section 512(a)(3)(B). Section 512(a)(3)(A) also applies to tax-exempt organizations described in section 501(c)(9), (17), or (20). The final regulations, however, do not provide relief from the general rules of the regulations for section 501(c)(7) organizations. Unlike section 528 homeowners associations, section 501(c)(7) social clubs are permitted to avoid gain recognition on certain asset sales. For example, if the club replaces the property sold with other property used directly in the performance of its tax-exempt function, no tax is owed on any gain recognized. Because of these exceptions, the IRS and Treasury Department believe that deferring tax on transfers of assets to section 501(c)(7) organizations would not be consistent with *General Utilities* repeal. Accordingly, the final regulations follow the proposed regulations and apply to transfers of assets to section 501(c)(7) organizations.

2. Change in Status Rule

A significant number of commentators contended that the Change in Status Rule could have a major adverse effect on mutual or cooperative electric companies that are tax-exempt as organizations described in section 501(c)(12). That section provides tax exemption for benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations (including mutual or cooperative electric companies), but only if more than 85 percent of their income is collected from members for the sole purpose of meeting losses and expenses. The 85 percent test is applied annually, so that an electric cooperative could be taxable one year and tax-exempt the next year. The commentators requested that electric cooperatives be given relief from the Change in Status Rule because business exigencies may cause these cooperatives to fail the 85 percent test. They also noted that the relief provided in the proposed regulations for organizations temporarily losing their exempt status was insufficient because more than 3 years may elapse before the organization once again meets the 85 percent test.

In addition to meeting the 85 percent test, section 501(c)(12) organizations must operate according to cooperative principles to be eligible for exemption. See Rev. Rul. 72–36, 1972–1 C.B. 151; *Buckeye Countrymark, Inc.* v. *Commissioner*, 103 T.C. 547, 554–555 (1994), *acq. on other issues*, 1997–1 C.B. 1; *Puget Sound Plywood, Inc.* v. *Commissioner*, 44 T.C. 305, 308 (1965), *acq. on other issues*, 1966–2 C.B. 6. An organization may operate according to cooperative principles yet fail the 85 percent test. Congress anticipated that section 501(c)(12) mutual or cooperative organizations could alternate between taxable and tax-exempt status due to the operation of the 85 percent income requirement. The IRS and Treasury Department do not believe it is appropriate to treat these entities as having disposed of all their assets when they regain tax-exempt status where the sole reason for their becoming taxable was the failure to meet the 85 percent test. Therefore, the final regulations provide that the Change in Status Rule does not apply when an organization previously tax-exempt as an organization described in section 501(c)(12) loses exemption solely because it fails the 85 percent test and later regains tax-exempt status, provided that in each intervening taxable year it meets all the requirements for exemption under section 501(c)(12) except for the 85 percent test.

One commentator suggested that because social clubs alternate between taxable and tax-exempt status they should be given relief similar to that requested by section 501(c)(12) organizations. Social clubs can lose their tax exemption if they generate excessive nonmember income in a particular year. See S. Rep. No. 1318, 94th Cong., 2d Sess. 4 (1976), 1976–2 C.B. 599. After considering this comment and the Service's experience with these organizations, we have concluded that the 3-Year Rule will provide adequate relief for social clubs from inappropriate application of the Change in Status Rule.

A number of commentators urged exempting newly formed social clubs from the application of the regulations if they become tax-exempt within seven years of their formation, rather than within the three-year period provided for other tax-exempt entities. Those commentators explained that some social clubs are organized when a real estate developer acquires land to be used for a housing development and a social club for the homeowners. The assets of the future social club are held by a corporation, but it cannot qualify as a tax-exempt section 501(c)(7) organization until several years later, after the stock or membership interests in the corporation have been transferred to the homeowners. Commentators familiar with development practices advised that it often takes up to seven years to transfer the club to the members' control. Furthermore, because the developer is forming the club as a business venture, the developer will work to realize the increase in the value of the club's assets as part of the transfer. For these reasons, providing additional time for newly-formed clubs to become tax-exempt does not conflict with *General Utilities* repeal. Therefore, the final regulations incorporate the recommendation made in the comments and provide that a social club will not be subject to the Change in Status Rule if it converts to tax-exempt status within seven taxable years after the year in which it was formed.

Two commentators suggested that the Change in Status Rule could adversely affect a taxable property and casualty insurance company that becomes tax-exempt as an organization described in section 501(c)(15) when it encounters financial difficulties leading to conservation or liquidation proceedings pursuant to authority granted by a state regulatory agency. A taxable property or casualty insurance company whose net written premiums or direct written premiums are $350,000 or less for the taxable year is eligible to be exempt from tax under section 501(c)(15). The final regulations provide an exception from the Change in Status Rule if in a taxable year an insurance company becomes an organization described in section 501(c)(15), and during that year and all subsequent years in which it is exempt under that section, the insurance company is the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding. In such cases, the reduction in premium income to $350,000 or less is likely to be involuntary and a direct result of the state proceeding. However, the final regulations continue to apply the Change in Status Rule to all other insurance companies qualifying for tax exemption under section 501(c)(15).

3. UBTI Rule

Some commentators asked how the UBTI Rule would apply when assets that are transferred to a tax-exempt entity are used partly in an activity of the organization the income from which is subject to tax under section 511(a) (''section 511(a) activity'') and partly in other activities. The UBTI Rule in the proposed regulations defers gain recognition with respect to those assets that will be used in a section 511(a) activity of the tax-exempt entity after the asset is transferred to the tax-exempt entity or after the taxable corporation converts to tax-exempt status. The final regulations provide that, if an asset will be used partly or wholly in a section 511(a) activity of a tax-exempt entity, the taxable corporation will recognize an amount of gain or loss that bears the same ratio to the asset's built-in gain or loss as 100 percent reduced by the percentage of use in the section 511(a) activity bears to 100 percent. The taxable corporation generally may rely on a written representation from the tax-exempt entity as to the anticipated percentage of use of the asset in a section 511(a) activity during the first taxable year after the transfer or change in status. If the percentage of an asset's use in the section 511(a) activity later decreases from the estimate used in computing gain or loss when the asset was transferred, the tax-exempt entity will recognize part of the deferred gain or loss in an amount that is proportionate to the decrease in use in the section 511(a) activity, and the gain or loss recognized will be subject to tax under section 511(a). The tax-exempt entity must use the same reasonable method of allocation for determining the percentage it uses assets in the section 511(a) activity for purposes of the UBTI Rule as it uses for other tax purposes (e.g., depreciation deductions). The tax-exempt entity also must use this same reasonable method of allocation for each taxable year that it holds the assets.

One commentator asked that gain not be recognized when a tax-exempt entity disposes of an asset used in a section 511(a) activity in a transaction eligible for nonrecognition treatment under the Code. The proposed regulations provide that gain is recognized on such dispositions ''notwithstanding any other provision of law,'' corresponding with the rule in section 337(b)(2)(B)(ii), and overruling the application of nonrecognition provisions such as section 512(b)(5). In response to these comments, the final regulations allow continuing deferral to the extent that the tax-exempt entity disposes of assets in a transaction that qualifies for nonrecognition of gain or loss under section 1031 or section 1033, but only to the extent that the replacement asset is used in a section 511(a) activity. No exception is made with respect to other nonrecognition provisions.

Special Analyses

It has been determined that this Treasury Decision 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. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the Internal Revenue Service's estimate that only 25 entities per year will be responding to the collection of information, and that the total annual reporting burden of this information collection for all responding entities will be only 125 hours. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f), the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Stephen R. Cleary of the Office of Assistant Chief Counsel (Corporate), IRS. 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.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for 26 CFR Part 1 is amended by adding an entry in numerical order to read as follows:

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

Section 1.337(d)–4 also issued under 26 U.S.C. 337. * * *

Par. 2. Section 1.337(d)–4 is added to read as follows:

§ 1.337(d)–4 Taxable to tax-exempt.

(a) *Gain or loss recognition*—(1) *General rule.* Except as provided in paragraph (b) of this section, if a taxable corporation transfers all or substantially all of its assets to one or more tax-exempt entities, the taxable corporation must recognize gain or loss immediately before the transfer as if the assets transferred were sold at their fair market values. But see section 267 and paragraph (d) of this section concerning limitations on the recognition of loss.

(2) *Change in corporation's tax status treated as asset transfer.* Except as provided in paragraphs (a)(3) and (b) of this section, a taxable corporation's change in status to a tax-exempt entity will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the change in status becomes effective in a transaction to which paragraph (a)(1) of this section applies. For example, if a state, a political subdivision thereof, or an entity any portion of whose income is excluded from gross income under

section 115, acquires the stock of a taxable corporation and thereafter any of the taxable corporation's income is excluded from gross income under section 115, the taxable corporation will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the stock acquisition.

(3) *Exceptions for certain changes in status*—(i) *To whom available.* Paragraph (a)(2) of this section does not apply to the following corporations—

(A) A corporation previously tax-exempt under section 501(a) which regains its tax-exempt status under section 501(a) within three years from the later of a final adverse adjudication on the corporation's tax exempt status, or the filing by the corporation, or by the Secretary or his delegate under section 6020(b), of a federal income tax return of the type filed by a taxable corporation;

(B) A corporation previously tax-exempt under section 501(a) or that applied for but did not receive recognition of exemption under section 501(a) before January 15, 1997, if such corporation is tax-exempt under section 501(a) within three years from January 28, 1999;

(C) A newly formed corporation that is tax-exempt under section 501(a) (other than an organization described in section 501(c)(7)) within three taxable years from the end of the taxable year in which it was formed;

(D) A newly formed corporation that is tax-exempt under section 501(a) as an organization described in section 501(c)(7) within seven taxable years from the end of the taxable year in which it was formed;

(E) A corporation previously tax-exempt under section 501(a) as an organization described in section 501(c)(12), which, in a given taxable year or years prior to again becoming tax-exempt, is a taxable corporation solely because less than 85 percent of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses; if, in a taxable year, such a corporation would be a taxable corporation even if 85 percent or more of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses (a non-85 percent violation), paragraph (a)(3)(i)(A) of this section shall apply as if the corporation became a taxable corporation in its first taxable year that a non-85 percent violation occurred; or

(F) A corporation previously taxable that becomes tax-exempt under section 501(a) as an organization described in section 501(c)(15) if during each taxable year in which it is described in section 501(c)(15) the organization is the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding; if such a corporation continues to be described in section 501(c)(15) in a taxable year when it is no longer the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding, paragraph (a)(2) of this section shall apply as if the corporation first became tax-exempt for such taxable year.

(ii) *Application for recognition.* An organization is deemed to have or regain tax-exempt status within one of the periods described in paragraph (a)(3)(i)(A), (B), (C), or (D) of this section if it files an application for recognition of exemption with the Commissioner within the applicable period and the application either results in a determination by the Commissioner or a final adjudication that the organization is tax-exempt under section 501(a) during any part of the applicable period. The preceding sentence does not require the filing of an application for recognition of exemption by any organization not otherwise required, such as by § 1.501(a)-1, § 1.505(c)-1T, and § 1.508–1(a), to apply for recognition of exemption.

(iii) *Anti-abuse rule.* This paragraph (a)(3) does not apply to a corporation that, with a principal purpose of avoiding the application of paragraph (a)(1) or (a)(2) of this section, acquires all or substantially all of the assets of another taxable corporation and then changes its status to that of a tax-exempt entity.

(4) *Related transactions.* This section applies to any series of related transactions having an effect similar to any of the transactions to which this section applies.

(b) *Exceptions.* Paragraph (a) of this section does not apply to—

(1) Any assets transferred to a tax-exempt entity to the extent that the assets are used in an activity the income from which is subject to tax under section 511(a) (referred to hereinafter as a ''section 511(a) activity''). However, if assets used to any extent in a section 511(a) activity are disposed of by the tax-exempt entity, then, notwithstanding any other provision of law (except section 1031 or section 1033), any gain (not in excess of the amount not recognized by reason of the preceding sentence) shall be included in the tax-exempt entity's unrelated business taxable income. To the extent that the tax-exempt entity ceases to use the assets in a section 511(a) activity, the entity will be treated for purposes of this paragraph (b)(1) as having disposed of the assets on the date of the cessation for their fair market value. For purposes of paragraph (a)(1) of this section and this paragraph (b)(1)—

(i) If during the first taxable year following the transfer of an asset or the corporation's change to tax-exempt status the asset will be used by the tax-exempt entity partly or wholly in a section 511(a) activity, the taxable corporation will recognize an amount of gain or loss that bears the same ratio to the asset's built-in gain or loss as 100 percent reduced by the percentage of use for such taxable year in the section 511(a) activity bears to 100 percent. For purposes of determining the gain or loss, if any, to be recognized, the taxable corporation may rely on a written representation from the tax-exempt entity estimating the percentage of the asset's anticipated use in a section 511(a) activity for such taxable year, using a reasonable method of allocation, unless the taxable corporation has reason to believe that the tax-exempt entity's representation is not made in good faith;

(ii) If for any taxable year the percentage of an asset's use in a section 511(a) activity decreases from the estimate used in computing gain or loss recognized under paragraph (b)(1)(i) of this section, adjusted for any decreases taken into account under this paragraph (b)(1)(ii) in prior taxable years, the tax-exempt entity shall recognize an amount of gain or loss that bears the same ratio to the asset's built-in gain or loss as the percentage point decrease in use in the section 511(a) activity for the taxable year bears to 100 percent;

(iii) If property on which all or a portion of the gain or loss is not recognized by reason of the first sentence of paragraph (b)(1) of this section is disposed of in a transaction that qualifies for nonrecognition treatment under section 1031 or section 1033, the tax-exempt entity must treat the replacement property as remaining subject to paragraph (b)(1) of this section to the extent that the exchanged or involuntarily converted property was so subject;

(iv) The tax-exempt entity must use the same reasonable method of allocation for determining the percentage that it uses the assets in a section 511(a) activity as it uses for other tax purposes, such as determining the amount of depreciation deductions. The tax-exempt entity also must use this same reasonable method of allocation for each taxable year that it holds the assets; and

(v) An asset's built-in gain or loss is the amount that would be recognized under paragraph (a)(1) of this section except for this paragraph (b)(1);

(2) Any transfer of assets to the extent gain or loss otherwise is recognized by the taxable corporation on the transfer. See, for example, sections 336, 337(b)(2), 367, and 1001;

(3) Any transfer of assets to the extent the transaction qualifies for nonrecognition treatment under section 1031 or section 1033; or

(4) Any forfeiture of a taxable corporation's assets in a criminal or civil action to the United States, the government of a possession of the United States, a state, the District of Columbia, the government of a foreign country, or a political subdivision of any of the foregoing; or any expropriation of a taxable corporation's assets by the government of a foreign country.

(c) *Definitions.* For purposes of this section:

(1) *Taxable corporation.* A *taxable corporation* is any corporation that is not a tax-exempt entity as defined in paragraph (c)(2) of this section.

(2) *Tax-exempt entity.* A *tax-exempt entity* is—

(i) Any entity that is exempt from tax under section 501(a) or section 529;

(ii) A charitable remainder annuity trust or charitable remainder unitrust as defined in section 664(d);

(iii) The United States, the government of a possession of the United States, a state, the District of Columbia, the government of a foreign country, or a political subdivision of any of the foregoing;

(iv) An Indian Tribal Government as defined in section 7701(a)(40), a subdivision of an Indian Tribal Government determined in accordance with section 7871(d), or an agency or instrumentality of an Indian Tribal Government or subdivision thereof;

(v) An Indian Tribal Corporation organized under section 17 of the Indian Reorganization Act of 1934, 25 U.S.C. 477, or section 3 of the Oklahoma Welfare Act, 25 U.S.C. 503;

(vi) An international organization as defined in section 7701(a)(18);

(vii) An entity any portion of whose income is excluded under section 115; or

(viii) An entity that would not be taxable under the Internal Revenue Code for reasons substantially similar to those applicable to any entity listed in this paragraph (c)(2) unless otherwise explicitly made exempt from the application of this section by statute or by action of the Commissioner.

(3) *Substantially all.* The term *substantially all* has the same meaning as under section 368(a)(1)(C).

(d) *Loss limitation rule.* For purposes of determining the amount of gain or loss recognized by a taxable corporation on the transfer of its assets to a tax-exempt entity under paragraph (a) of this section, if assets are acquired by the taxable corporation in a transaction to which section 351 applied or as a contribution to capital, or assets are distributed from the taxable corporation to a shareholder or another member of the taxable corporation's affiliated group, and in either case such acquisition or distribution is made as part of a plan a principal purpose of which is to recognize loss by the taxable corporation on the transfer of such assets to the tax-exempt entity, the losses recognized by the taxable corporation on such assets transferred to the tax-exempt entity will be disallowed. For purposes of the preceding sentence, the principles of section 336(d)(2) apply.

(e) *Effective date.* This section is applicable to transfers of assets as described in paragraph (a) of this section occurring after January 28, 1999, unless the transfer is pursuant to a written agreement which is (subject to customary conditions) binding on or before January 28, 1999.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

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

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * *	*
1.337(d)–4	1545–1633
* * * *	*

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved: December 17, 1998.

Dated: December 17, 1998.

Donald C. Lubick,

Assistant Secretary of the Treasury.

[FR Doc. 98–34210 Filed 12–28–98; 8:45 am]

BILLING CODE 4830–01–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 300

[FRL–6209–8]

National Oil and Hazardous Substances Pollution Contingency Plan; National Priorities List

AGENCY: Environmental Protection Agency (EPA).

ACTION: Notice of deletion from the Frontera Creek Superfund Site from the National Priorities List.

SUMMARY: The Environmental Protection Agency (EPA) announces the deletion of the Frontera Creek Superfund Site (Site) located in Rio Abajo within the Municipality of Humacao, Puerto Rico, from the National Priorities List (NPL). The NPL is Appendix B of 40 CFR Part 300 which is the National Oil and Hazardous Substances Pollution Contingency Plan (NCP), which EPA promulgated pursuant to Section 105 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), as amended. EPA and the Puerto Rico Environmental Quality Board have determined that the Site poses no significant threat to public health or the environment and, therefore, no further response actions pursuant to CERCLA are appropriate.

EFFECTIVE DATE: December 29, 1998.

FOR FURTHER INFORMATION CONTACT: Luis E. Santos, Remedial Project Manager, U.S. Environmental Protection Agency, Region 2, Caribbean Environmental Protection Division (CEPD), Centro Europa Building, Suite 417, 1492 Ponce de León Ave., Stop 22, San Juan, Puerto Rico 00907–4127, (787) 729–6951 Ext. 223.

SUPPLEMENTARY INFORMATION: The Site to be deleted from the NPL is: the Frontera Creek Superfund Site, Rio Abajo, Puerto Rico.

A Notice of Intent to Delete for this Site was published on July 30, 1998 (63 FR 40685–40687). The closing date for comments on the Notice of Intent to Delete was August 31, 1998. EPA held a public availability session on the proposal to delete the Site from the NPL on August 20, 1998 at the Humacao Town Hall. EPA received two letters offering comments. EPA responded to the letters and no further action is required. Copies of the letters and the responses are available in the Administrative Record File.

EPA identifies sites that appear to present a significant risk to public health, welfare, or the environment and it maintains the NPL as the list of those