responsibilities among the various levels of government as described by E.O. 13132. Therefore, we have determined that this Final Rule will not have a sufficient federalism implication to warrant the preparation of a summary impact statement.

F. Executive Order 13175—Indian Tribal Governments

We reviewed this Final Rule under the terms of E.O. 13175 and determined it not to have tribal implications. The Final Rule does not have substantial direct effects on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes. As a result, no tribal summary impact statement has been prepared.

G. Assessment of Federal Regulations and Policies on Families

Section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. 105–277, 112 Stat. 2681) requires us to assess the impact of this Final Rule on family well-being. A rule that is determined to have a negative effect on families must be supported with an adequate rationale. We have assessed this Final Rule and determined that it will not have a negative effect on families.

H. Executive Order 12630—Government Actions and Interference With Constitutionally Protected Property Rights

The Final Rule is not subject to E.O. 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights, because it does not involve implementation of a policy with takings implications.

I. Executive Order 12988—Civil Justice

The Final Rule has been drafted and reviewed in accordance with E.O. 12988, Civil Justice Reform, and will not unduly burden the Federal court system. The Department has developed the Final Rule to minimize litigation and provide a clear legal standard for affected conduct, and has reviewed the Final Rule carefully to eliminate drafting errors and ambiguities.

J. Plain Language

We drafted this Final Rule in plain language.

K. Paperwork Reduction Act

As part of our continuing effort to reduce paperwork and respondent burden, we conduct a preclearance consultation program to provide the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506(c)(2)(A)). This process helps to ensure that the public understands the collection instructions; that respondents provide requested data in the desired format; that reporting burden (time and financial resources) is minimized; that collection instruments are clearly understood; and that we properly assess the impact of collection requirements on respondents.

The PRA requires all Federal agencies to analyze proposed regulations for potential time burdens on the regulated community created by provisions within the proposed regulations that require the submission of information. These information collection (IC) requirements must be submitted to the OMB for approval. Persons are not required to respond to a collection of information unless it displays a currently valid OMB control number as required in 5 CFR 1320.11(l) or it is exempt from the PRA.

The majority of the IC requirements for the current H–2B program are approved under OMB control number 1205–0466 (which includes ETA Form 9141 and ETA Form 9142). There are no burden adjustments that need to be made to the analysis. For an additional explanation of how we calculated the burden hours and related costs, the PRA package for information collection OMB control number 1205–0466 may be obtained at *http://www.RegInfo.gov.*

IV. Change of Effective Date of Wage Rule

In the final rule published January 19, 2011, 76 FR 3452, under the **DATES** section, the effective date of the final rule is amended to read as follows:

This final rule is effective September 30, 2011.

Signed in Washington, this 26th day of July 2011.

Jane Oates,

Assistant Secretary, Employment and Training Administration.

[FR Doc. 2011–19319 Filed 7–29–11; 8:45 am]

BILLING CODE 4510–FP–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9534]

RIN 1545–BD81

Methods of Accounting Used by Corporations That Acquire the Assets of Other Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the methods of accounting, including the inventory methods, to be used by corporations that acquire the assets of other corporations in certain corporate reorganizations and tax-free liquidations. These regulations clarify and simplify the rules regarding the accounting methods to be used following these reorganizations and liquidations.

DATES: *Effective date:* These regulations are effective on August 31, 2011.

Applicability date: For dates of applicability, see §§ 1.381(a)–1(e), 1.381(c)(4)–1(f), 1.381(c)(5)–1(f), and 1.446–1(e)(4)(iii).

FOR FURTHER INFORMATION CONTACT: Cheryl Oseekey at (202) 622–4970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1. On November 16, 2007, the IRS and the Treasury Department published a notice of proposed rulemaking (REG–151884–03) in the **Federal Register** (72 FR 64545). This notice of proposed rulemaking, while continuing most of the provisions of the regulations originally issued under sections 381(c)(4) and 381(c)(5) of the Internal Revenue Code (Code) regarding the methods of accounting to be used by a corporation that acquires the assets of another corporation in a section 381(a) transaction, proposed to clarify and simplify those existing regulations. The IRS received no comments in response to the notice of proposed rulemaking. No public hearing was requested or held. The proposed regulations, as revised by this Treasury decision, are adopted as final regulations.

Explanation of Provisions

The final regulations differ somewhat in organization and format from the notice of proposed rulemaking. These changes are intended to be editorial in nature and are not intended to alter the substance and principles of the rules set forth in the notice of proposed rulemaking. The IRS and the Treasury Department made these changes to further advance the objective, as expressed in the preamble to the notice of proposed rulemaking, of reducing uncertainty and controversy by providing regulations under sections 381(c)(4) and 381(c)(5) that are clear, consistent, and administrable. For example, the final regulations under sections 381(c)(4) and 381(c)(5) have been drafted so that the regulations mirror each other to the greatest extent possible, thus highlighting the consistencies of the regulations' provisions. Similarly, many of the examples in the notice of proposed rulemaking have been revised in the final regulations to specify the substantive tax rule in the regulations that the examples illustrate. Additionally, new examples were added to the final regulations to provide further illustrations of the substantive tax rules in these regulations.

The keystone of the final regulations for sections 381(c)(4) and 381(c)(5) continues to be whether the acquiring corporation operates the trades or businesses of the parties to a section 381(a) transaction as separate and distinct trades or businesses following the date of distribution or transfer. The final regulations continue to provide that when the acquiring corporation operates the trades or businesses of the parties as separate and distinct trades or businesses after the date of distribution or transfer, the acquiring corporation will use a carryover method. In contrast, when the acquiring corporation does not operate the trades or businesses of the parties as separate and distinct trades or businesses after the date of distribution or transfer, the acquiring corporation will use a principal method. These rules do not apply when a carryover method or principal method, as applicable, is not a permissible method, or when the acquiring corporation chooses not to use a carryover method or principal method. In those cases, the general rules under section 446(e) that govern methods of accounting apply.

The final regulations modify the test for determining a principal method when the acquiring corporation does not operate the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer. Under the final regulations, the determination of whether the distributor or transferor corporation is larger than the acquiring corporation is made by comparing certain attributes (that is, under section 381(c)(4) the adjusted bases of the assets and gross receipts, and under section 381(c)(5) the fair market value of the inventory) of only the trades or businesses that will be integrated after the date of distribution or transfer rather than comparing the attributes for the entire entity. The IRS and the Treasury Department believe that the attributes of a trade or business that will continue to operate as a separate and distinct trade or business after the date of distribution or transfer should not influence the determination of a principal method that will be used by trades or businesses that will be integrated after the date of distribution or transfer. The IRS and the Treasury Department also believe that applying the test at the trade or business level is consistent with § 1.446–1(d) because methods of accounting are generally determined at the trade or business level.

The final regulations also provide rules on how an acquiring corporation identifies a principal method when an acquiring corporation or a distributor or transferor corporation operates more than one separate and distinct trade or business on the date of distribution or transfer, has more than one method of accounting used in the trades or businesses, and the acquiring corporation combines the trades or businesses after the date of distribution or transfer. While the IRS and the Treasury Department do not think these situations occur frequently, the final regulations are revised to provide certainty for an acquiring corporation and to obviate the need to obtain a ruling in these situations.

The final regulations under sections 381(c)(4) and 381(c)(5) clarify the definition of ''cut-off basis.'' The final regulations provide that *cut-off basis* generally means a manner in which a change in method of accounting is made without a section 481(a) adjustment and under which only the items arising after the beginning of the year of change (or, in the case of a change made to a principal method, only the items arising after the date of distribution or transfer) are accounted for under the new method of accounting. The definition of cut-off basis is expanded in the final regulations under section 381(c)(5) to clarify that a taxpayer that makes a change within the last-in, first-out (LIFO) inventory method from one LIFO method or sub-method to another LIFO method or sub-method does not recompute the cost of its beginning inventories for the year of change under the new LIFO inventory method when it implements the change on a cut-off basis.

The final regulations under section 381(c)(5) also make certain organizational changes to § 1.381(c)(5)–1(e)(6) of the notice of proposed rulemaking with respect to the integration of inventories after a section 381(a) transaction. These changes do not change the substantive rules in the notice of proposed rulemaking but are intended to clarify that the rules apply whether the inventory method of either the acquiring corporation or the transferor or distributor corporation must be changed to a principal method. The IRS and the Treasury Department are considering issuing additional guidance that would clarify or modify the manner in which inventories must be combined and integrated in a section 381(a) transaction.

Finally, the final regulations correct the discussion of section 472(d) that was in § 1.381(c)(5)–1(e)(6)(ii)(B) of the notice of proposed rulemaking. Section 1.381(c)(5)–1(e)(6)(ii)(B) of the notice of proposed rulemaking provided that the restoration to cost of any previous write-downs to market value shall be taken into account fully in the year that included the date of distribution or transfer. Consistent with the amendments to section 472(d), the final regulations provide that these restorations shall be taken into account by the acquiring corporation ratably in each of the three taxable years beginning with the taxable year that includes the date of the distribution or transfer.

The IRS and the Treasury Department are aware that some practitioners were concerned that the notice of proposed rulemaking did not provide audit protection when an acquiring corporation uses a principal method after the date of distribution or transfer. For the reasons expressed in the preamble to the notice of proposed rulemaking, the final regulations continue to deny audit protection in these circumstances. Unlike changes in method of accounting under section 446(e) for which a taxpayer must disclose its use of a method of accounting, proper or improper, as part of the process for obtaining consent to make the change, changes to a principal method pursuant to these final regulations are made on the acquiring corporation's tax return with no disclosure on a Form 3115, ''Application for Change in Accounting Method,'' that a change in method of accounting occurred.

The IRS and the Treasury Department are aware that some taxpayers desire to obtain audit protection for a required change to a principal method by filing a Form 3115. However, the IRS and the Treasury Department believe that, given the need for efficient tax administration, filing a Form 3115 merely to obtain audit protection should not be allowed. Although audit protection is not provided for a change to a principal method required under these regulations, audit protection ordinarily is provided for any voluntary change in method of accounting for which a party to a section 381(a) transaction obtains consent under section 446(e) and the generally applicable administrative procedures.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. This certification is based on the belief of the IRS and the Treasury Department that the corporate reorganizations and tax-free liquidations described in section 381(a) generally involve large entities. In addition, these final regulations reduce the burden on taxpayers by clarifying and simplifying the existing rules and make the procedures for requesting changes in methods of accounting relating to corporate reorganizations and tax-free liquidations described in section 381(a) consistent with the general rules for requesting changes in methods of accounting. Pursuant to section 7805(f), 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. Consistent with 5 U.S.C. section 553(d), the regulations are effective 30 days after publication of this document in the **Federal Register**.

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.381(c)(4)–1 also issued under 26 U.S.C. 381(c)(4). * * *

Section 1.381(c)(5)–1 also issued under 26 U.S.C. 381(c)(5). * * *

■ **Par. 2.** In § 1.381(a)–1, paragraph (b)(1)(i) is revised and paragraph (e) is added to read as follows:

§ 1.381(a)–1 General rule relating to carryovers in certain corporate acquisitions.

* * * * *

(b) * * *

(1) * * * (i) The complete liquidation of a subsidiary corporation upon which no gain or loss is recognized in accordance with the provisions of section 332;

* * * * *

(e) *Effective/applicability date.* The rules of paragraph (b)(1)(i) of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

■ **Par. 3.** Section 1.381(c)(4)–1 is revised to read as follows:

§ 1.381(c)(4)–1 Method of accounting.

(a) *Introduction*—(1) *Purpose.* This section provides guidance regarding the method of accounting or combination of methods (other than inventory and depreciation methods) an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(4) apply and how to implement any associated change in method of accounting. See § 1.381(c)(5)–1 for guidance regarding the inventory method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(5) apply. See § 1.381(c)(6)–1 for guidance regarding the depreciation method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(6) apply.

(2) *Carryover method requirement for separate and distinct trades or businesses.* In a transaction to which section 381(a) applies, if an acquiring corporation continues to operate a trade or business of the parties to the section 381(a) transaction as a separate and distinct trade or business after the date of distribution or transfer, the acquiring corporation must use a carryover method as defined in paragraph (b)(5) of this section for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or the acquiring corporation changes the carryover method in accordance with paragraph (a)(5) of this section. The carryover method requirement applies to the overall method of accounting (for example, an accrual method of accounting) and any special method of accounting (for example, the percentage of completion method of accounting described in section 460) as defined in paragraph (b)(2) of this section used by each trade or business after the date of distribution or transfer. The acquiring corporation need not secure the Commissioner's consent to continue a carryover method.

(3) *Principal method requirement for trades or businesses not operated as separate and distinct trades or businesses.* In a transaction to which section 381(a) applies, if an acquiring corporation does not operate the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer, the acquiring corporation must use a principal method determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or the acquiring corporation changes the principal method in accordance with paragraph (a)(5) of this section. The principal method requirement applies to the overall method of accounting (for example, the cash receipts and disbursements method of accounting) and any special method of accounting (for example, the installment method under section 453) as defined in paragraph (b)(2) of this section used by each integrated trade or business after the date of distribution or transfer. The acquiring corporation must change to a principal method in accordance with paragraph (d)(1) of this section for each integrated trade or business and need not secure the Commissioner's consent to use a principal method.

(4) *Carryover method or principal method not a permissible method.* If a carryover method or principal method is not a permissible method of accounting, the acquiring corporation must secure the Commissioner's consent to change to a permissible method of accounting as provided in paragraph (d)(2) of this section. If the acquiring corporation must use a single method of accounting for a particular item after the date of distribution or transfer regardless of the

number of separate and distinct trades or businesses operated on that date, the acquiring corporation must use the principal method for that item as determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under this paragraph (a)(4) or the acquiring corporation changes the principal method in accordance with paragraph (a)(5) of this section.

(5) *Voluntary change.* Any party to a section 381(a) transaction may request permission under section 446(e) to change a method of accounting for the taxable year in which the transaction occurs or is expected to occur. For trades or businesses that will not operate as separate and distinct trades or businesses after the date of distribution or transfer, a change in method of accounting for the taxable year that includes that date will be granted only if the requested method is the method that the acquiring corporation must use after the date of distribution or transfer. The time and manner of obtaining the Commissioner's consent to change to a different method of accounting is described in paragraph (d)(2) of this section.

(6) *Examples.* The following examples illustrate the rules of this paragraph (a). Unless otherwise noted, the carryover method is a permissible method of accounting.

Example (1). *Carryover method for separate and distinct trades or businesses after the date of distribution or transfer*—(i) *Facts.* X Corporation operates an employment agency that uses the overall cash receipts and disbursements method of accounting. T Corporation operates an educational institution that uses an overall accrual method of accounting. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates the employment agency as a trade or business that is separate and distinct from the educational institution.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation operates the employment agency as a separate and distinct trade or business, under paragraph (a)(2) of this section X Corporation must use the carryover method for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover method in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(5) of this section, the carryover method for the employment agency is the cash receipts and disbursements method of accounting and the carryover method for the educational institution is the accrual method of accounting used by T Corporation immediately prior to the date of distribution or transfer. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use either carryover method.

Example (2). *Carryover method for a special method of accounting*—(i) *Facts.* X Corporation provides personal grooming consulting and T Corporation provides weight management consulting. Both X Corporation and T Corporation use the same overall accrual method of accounting. X Corporation has elected to use the recurring item exception under § 1.461–5. T Corporation does not use the recurring item exception. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates the personal grooming consulting business as a trade or business that is separate and distinct from the weight management consulting business.

(ii) *Conclusion.* Because after the date of distribution or transfer, X Corporation operates the personal grooming consulting business as a separate and distinct trade or business, under paragraph (a)(2) of this section X Corporation must use a carryover method for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover method in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(5) of this section, the carryover method for the overall method of accounting for each trade or business is the accrual method used immediately prior to the date of distribution or transfer. The carryover method for the special method of accounting for the personal grooming consulting business is the recurring item exception under § 1.461–5 while the carryover method for the weight management consulting business is not to use the recurring item exception under § 1.461–5. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use the carryover methods of accounting.

Example (3). *Carryover method for a special method of accounting not permissible*—(i) *Facts.* X Corporation is an engineering firm that uses the overall cash receipts and disbursements method of accounting and has elected under section 171 to amortize bond premium with respect to its taxable bonds acquired at a premium. T Corporation is a manufacturer that uses an overall accrual method of accounting and has not made a section 171 election to amortize bond premium with respect to its taxable bonds acquired at a premium. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates the engineering firm as a trade or business that is separate and distinct from the manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation operates the engineering firm as a separate and distinct trade or business, under paragraph (a)(2) of this section X Corporation must use a carryover method for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover method in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(5) of this section, the carryover method for the overall method of accounting for the engineering firm is the cash receipts and disbursements method used by X Corporation immediately prior to the date of distribution or transfer, and the carryover method for the overall method of accounting for the manufacturing business is the accrual method used by T Corporation immediately prior to the date of distribution or transfer. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use either carryover method. Notwithstanding that after the date of distribution or transfer X Corporation has two separate and distinct trades or businesses, X Corporation is permitted only one method of accounting for amortizable bond premium under section 171. Because after the date of distribution or transfer X Corporation must use a single method of accounting for bond premium for all trades or businesses, X Corporation must use the principal method for that item as determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes that method in accordance with paragraph (a)(5) of this section. X Corporation must change to the principal method in accordance with paragraph (d)(1) of this section. If amortizing bond premium is not the principal method, X Corporation may make an election to amortize bond premium to the extent permitted by section 171. See paragraph (e)(2) of this section for rules on making elections.

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

(1) *Method of accounting.* A method of accounting has the same meaning as provided in section 446 and any applicable Income Tax Regulations.

(2) *Special method of accounting.* A special method of accounting is a method expressly permitted or required by the Internal Revenue Code, Income Tax Regulations, or administrative guidance published in the Internal Revenue Bulletin that deviates from the normal application of the cash receipts and disbursements method or an accrual method of accounting. The installment method under section 453, the mark-to-market method under section 475, the amortization of bond premium under section 171, the percentage of completion method under section 460, the recurring item exception of § 1.461–5, and the income deferral methods under section 455 and § 1.451–5 are examples of special methods of accounting. See § 1.446–1(c)(1)(iii).

(3) *Adoption of a method of accounting.* Adoption of a method of accounting has the same meaning as provided in § 1.446–1(e)(1).

(4) *Change in method of accounting.* A change in method of accounting has the same meaning as provided in § 1.446–1(e)(2).

(5) *Carryover method.* A carryover method for the overall method of accounting is the overall method of accounting that each party to a section 381(a) transaction uses for each separate and distinct trade or business immediately prior to the date of distribution or transfer. The carryover method for a special method of accounting for an item is the special method of accounting for that item that each party to a section 381(a) transaction uses for each separate and distinct trade or business immediately prior to the date of distribution or transfer.

(6) *Principal method.* A principal method is an overall or special method of accounting that is determined under paragraph (c) of this section.

(7) *Permissible method of accounting.* A permissible method of accounting is a method of accounting that is proper or permitted under the Internal Revenue Code or any applicable Income Tax Regulations.

(8) *Acquiring corporation.* An acquiring corporation has the same meaning as provided in § 1.381(a)–1(b)(2).

(9) *Distributor corporation.* A distributor corporation means the corporation, foreign or domestic, that distributes its assets to another corporation described in section 332(b) in a distribution to which section 332 (relating to liquidations of subsidiaries) applies.

(10) *Transferor corporation.* A transferor corporation means the corporation, foreign or domestic, that transfers its assets to another corporation in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if—

(i) The transfer is in connection with a reorganization described in section 368(a)(1)(A), (a)(1)(C), or (a)(1)(F), or

(ii) The transfer is in connection with a reorganization described in section 368(a)(1)(D) or (a)(1)(G), provided the requirements of section 354(b) are met.

(11) *Parties to the section 381(a) transaction.* Parties to the section 381(a) transaction means the acquiring corporation and the distributor or transferor corporation that participate in a transaction to which section 381(a) applies.

(12) *Date of distribution or transfer.* The date of distribution or transfer has the same meaning as provided in section 381(b)(2) and § 1.381(b)–1(b).

(13) *Separate and distinct trades or businesses.* Separate and distinct trades or businesses has the same meaning as provided in § 1.446–1(d).

(14) *Gross receipts.* Gross receipts means all the receipts, including amounts that are excludible from gross income, that must be taken into account under the method of accounting used in a representative period (determined without regard to this section) for federal income tax purposes. For example, gross receipts includes income from investments, amounts received for services, rents, total sales (net of returns and allowances), and both taxable and tax-exempt interest. See paragraph (e)(5) of this section for rules on determining the representative period.

(15) *Audit protection.* Audit protection means, for purposes of paragraph (d)(1) of this section, that the IRS will not require an acquiring corporation that is required to change a method of accounting under paragraph (a)(3) of this section to change that method for a taxable year ending prior to the taxable year that includes the date of distribution or transfer.

(16) *Section 481(a) adjustment.* The section 481(a) adjustment means an adjustment that must be taken into account as required under section 481(a) to prevent amounts from being duplicated or omitted when the taxable income of an acquiring corporation is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year.

(17) *Cut-off basis.* A cut-off basis means a manner in which a change in method of accounting is made without a section 481(a) adjustment and under which only the items arising after the beginning of the year of change (or, in the case of a change made under paragraph (d)(1) of this section, after the date of distribution or transfer) are accounted for under the new method of accounting.

(18) *Adjustment period.* The adjustment period means the number of taxable years for taking into account the section 481(a) adjustment required as a result of a change in method of accounting.

(19) *Component trade or business.* A component trade or business is a trade or business of a party to the section 381(a) transaction that will be combined and integrated with a trade or business of the other party to the section 381 transaction. See paragraph (e)(4)(ii) of this section for the determination of whether a trade or business is operated as a separate and distinct trade or business after the date of distribution or transfer.

(c) *Principal method*—(1) *In general.* For each integrated trade or business, the principal method is generally the method of accounting used by the component trade or business of the acquiring corporation immediately prior to the date of distribution or transfer. If, however, the component trade or business of the distributor or transferor corporation is larger than the component trade or business of the acquiring corporation on the date of distribution or transfer, the principal method is the method used by the component trade or business of the distributor or transferor corporation immediately prior to that date. If the larger component trade or business does not have a special method of accounting for a particular item immediately prior to the date of distribution or transfer, the principal method for that item is the method of accounting used by the component trade or business that does have a special method of accounting for that item. See paragraph (e)(9) of this section for special rules concerning methods of accounting that are elected on a project-by-project, job-by-job, or other similar basis. For each integrated trade or business, the component trade or business of the distributor or transferor corporation is larger than the component trade or business of the acquiring corporation on the date of distribution or transfer if—

(i) The aggregate of the adjusted bases of the assets held by each component trade or business of the distributor or transferor corporation (determined under section 1011 and any applicable Income Tax Regulations) exceeds the aggregate of the adjusted bases of the assets of each component trade or business of the acquiring corporation immediately prior to the date of distribution or transfer, and

(ii) The aggregate of the gross receipts for a representative period of each component trade or business of the distributor or transferor corporation exceeds the aggregate of the gross receipts for the same period of each component trade or business of the acquiring corporation. See paragraph (e)(5) of this section for rules on determining the representative period.

(2) *Multiple component trades or businesses with different principal methods.* If a party to the section 381(a) transaction has multiple component trades or businesses and more than one principal overall method of accounting or more than one principal special method of accounting for an item, then the acquiring corporation may choose which of the principal methods of accounting used by such component trades or businesses will be the

principal methods of the integrated trade or business. The acquiring corporation must choose a principal method that is a permissible method of accounting. In general, a change to a principal method in a transaction to which section 381(a) and paragraph (a)(3) of this section applies is made under paragraph (d)(1) of this section.

(3) *Examples.* The following examples illustrate the rules of this paragraph (c). Unless otherwise noted, the principal method is a permissible method of accounting.

Example (1). *Principal method is the method used by the acquiring corporation*—(i) *Facts.* X Corporation and T Corporation each operate an employment agency. X Corporation uses the overall cash receipts and disbursements method of accounting, and T Corporation uses an overall accrual method of accounting. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. The adjusted bases of the assets in X Corporation's employment agency immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets in T Corporation's employment agency, and the gross receipts in X Corporation's employment agency for the representative period exceed the gross receipts of T Corporation's employment agency for the period. After the date of distribution or transfer, X Corporation's employment agency will not be operated as a trade or business that is separate and distinct from T Corporation's employment agency.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its employment agency as a separate and distinct trade or business, X Corporation must use a principal method under paragraph (a)(3) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal method in accordance with paragraph (a)(5) of this section. Because on the date of distribution or transfer T Corporation's employment agency is not larger than X Corporation's employment agency, the principal method for the overall method of accounting is the cash receipts and disbursements method used by X Corporation's employment agency. X Corporation need not secure the Commissioner's consent to use this method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the method of accounting for the employment agency acquired from T Corporation to the cash receipts and disbursements method.

Example (2). *Principal method is the method used by the acquiring corporation*—(i) *Facts.* The facts are the same as in *Example* (1), except that the gross receipts of T Corporation's employment agency for the representative period exceed the gross receipts of X Corporation's employment agency for the period.

(ii) *Conclusion.* The result is the same as in *Example* (1). Although the gross receipts of T Corporation's employment agency exceed the gross receipts of X Corporation's employment agency, T Corporation's employment agency is not larger than X Corporation's employment agency because the adjusted bases of the assets of T Corporation's employment agency do not exceed the adjusted bases of the assets of X Corporation's employment agency. Thus, the principal method for the overall method of accounting is the cash receipts and disbursements method of accounting used by X Corporation's employment agency immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use this method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the method of accounting for the employment agency business acquired from T Corporation to the cash receipts and disbursements method.

Example (3). *Principal method is the method used by the distributor or transferor corporation*—(i) *Facts.* The facts are the same as in *Example* (2), except that the adjusted bases of the assets held by T Corporation's employment agency immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets held by X Corporation's employment agency.

(ii) *Conclusion.* The principal method for the overall method of accounting is the accrual method of accounting used by T Corporation's employment agency immediately prior to the date of distribution or transfer because on the date of distribution or transfer T Corporation's employment agency is larger than X Corporation's employment agency. The adjusted bases of the assets of T Corporation's employment agency exceed the adjusted bases of the assets of X Corporation's employment agency, and the gross receipts of T Corporation's employment agency exceed the gross receipts of X Corporation's employment agency. X Corporation need not secure the Commissioner's consent to use this method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the method of accounting for the employment agency business it operated prior to the date of distribution or transfer to the accrual method of accounting used by T Corporation's employment agency immediately prior to the date of distribution or transfer.

Example (4). *Impermissible principal method*—(i) *Facts.* The facts are the same as in *Example* (1), except that X Corporation is prohibited under section 448 from using the cash receipts and disbursements method of accounting after the date of distribution or transfer.

(ii) *Conclusion.* Because section 448 prohibits X Corporation from using the cash receipts and disbursements method of accounting, X Corporation is not permitted to use the principal method for the overall method of accounting as determined in *Example* (1). Because after the date of distribution or transfer that method is not a permissible method, under paragraph (a)(4) of this section X Corporation must secure the Commissioner's consent to change to a permissible method in accordance with the procedures set forth in paragraph (d)(2) of this section.

Example (5). *Voluntary change not allowable*—(i) *Facts.* The facts are the same as in *Example* (4), except that T Corporation wants to discontinue using the overall accrual method of accounting for its employment agency and change to the cash receipts and disbursements method for the taxable year in which the section 381(a) transaction occurs or is expected to occur.

(ii) *Conclusion.* Under paragraph (a)(5) of this section, the Commissioner will grant a request to change a method of accounting for the taxable year that includes the date of distribution or transfer only if the requested method is the method that the acquiring corporation must use after the date of distribution or transfer. The Commissioner will not consent to a request by T Corporation to change to the cash receipts and disbursements method for the taxable year in which the section 381(a) transaction occurs or is expected to occur because X Corporation cannot use the cash receipts and disbursements method after the date of distribution or transfer.

Example (6). *Principal methods are the acquiring corporation's methods*—(i) *Facts.* X Corporation and T Corporation each publishes magazines. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. Both X Corporation and T Corporation use an overall accrual method of accounting. X Corporation has elected to defer income from its subscription sales under section 455. T Corporation has not elected to defer income from its subscription sales under section 455 and instead has recognized the income from these sales in accordance with section 451. The adjusted bases of the assets in X Corporation's publication business immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets in T Corporation's publication business, and the gross receipts in X Corporation's publication business for the representative period exceed the gross receipts in T Corporation's publication business for the representative period. After the date of distribution or transfer, X Corporation will not operate its publication business as a trade or business that is separate and distinct from T Corporation's publication business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its publication business as a separate and distinct trade or business, X Corporation must use the principal method under paragraph (a)(3) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal method in accordance with paragraph (a)(5) of this section. The adjusted bases of the assets in T Corporation's publication business do not exceed the adjusted bases of the assets in X Corporation's publication business, and the gross receipts in T Corporation's publication business do not exceed the gross receipts in X Corporation's publication business. Because on the date of distribution or transfer T Corporation's publication business is not larger than X Corporation's publication business, the principal method for the overall method of accounting is the accrual method used by X Corporation's publication business immediately prior to the date of distribution or transfer. The principal method for subscription sales is the section 455 deferral method used by X Corporation immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal method for either the overall method of accounting or the special method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change both the overall method of accounting and the special method of accounting for the publication business acquired from T Corporation to the accrual method and the section 455 deferral method used by X Corporation immediately prior to the date of distribution or transfer.

Example (7). *Principal methods are the acquiring corporation's methods*—(i) *Facts*. The facts are the same as in *Example* (6), except that the adjusted bases of the assets in T Corporation's publication business immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets in X Corporation's business.

(ii) *Conclusion*. The result is the same as in *Example* (6). Because on the date of distribution or transfer T Corporation's publication business is not larger than X Corporation's publication business, the principal method for the overall method of accounting is the accrual method used by X Corporation's publication business immediately prior to the date of distribution or transfer. The principal method for subscription sales is the section 455 deferral method used by X Corporation immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal method for either the overall method of accounting or the special method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change both the overall method of accounting and the special method of accounting for the publication business acquired from T Corporation to the accrual method and the section 455 deferral method used by X Corporation immediately prior to the date of distribution or transfer.

Example (8). *Principal method determination when larger component trade or business does not have a special method of accounting*—(i) *Facts*. X Corporation and T Corporation both install ice skating rinks. Both X Corporation and T Corporation use an overall accrual method of accounting for their respective businesses. X Corporation completes its installation contracts within the contracting year and uses an accrual method of accounting to recognize the revenue from its installation contracts. T Corporation's installation contracts are subject to section 460, and T Corporation recognizes the revenue from such contracts under the percentage-of-completion method. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. The adjusted bases of the assets in X Corporation's installation business immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets in T Corporation's installation business, and the gross receipts in X Corporation's installation business for the representative period exceed the gross receipts in T Corporation's installation business for the representative period. After the date of distribution or transfer, X Corporation will not operate its installation business as a trade or business that is separate and distinct from T Corporation's installation business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its installation business as a separate and distinct trade or business, X Corporation must use a principal method under paragraph (a)(3) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal method in accordance with paragraph (a)(5) of this section. The adjusted bases of the assets in T Corporation's installation business do not exceed the adjusted bases of the assets in X Corporation's installation business, and the gross receipts in T Corporation's installation business do not exceed the gross receipts in X Corporation's installation business. Because on the date of distribution or transfer T Corporation's installation business is not larger than X Corporation's installation business, the principal method for the overall method of accounting is the accrual method used by X Corporation's installation business immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal method for the overall method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the overall method of accounting for the installation business acquired from T Corporation to the accrual method used by X Corporation. Under paragraph (c) of this section, the principal method for T Corporation's long-term contracts is the percentage-of-completion method used by T Corporation immediately prior to the date of distribution or transfer because X Corporation's installation business does not have a method of accounting for long-term contracts. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use T Corporation's percentage-of-completion method.

Example (9). *Principal method determination with a combined trade or business and a separate and distinct trade or business*—(i) *Facts.* X Corporation operates a tennis academy as a trade or business that is separate and distinct from its trade or business of operating a golf academy. X Corporation uses the overall cash receipts and disbursements method of accounting for the tennis academy and an overall accrual method of accounting for the golf academy. T Corporation operates a tennis academy and uses an accrual method of accounting for the overall method. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation will not operate its tennis academy as a trade or business that is separate and distinct from T Corporation's tennis academy. X Corporation will continue to operate its golf academy as a trade or business that is separate and distinct from the operation of the tennis academy. The adjusted bases of the assets in T Corporation's tennis academy exceed the adjusted bases of the assets in X Corporation's tennis academy immediately prior to the date of distribution or transfer. The gross receipts of T Corporation's tennis academy for the representative period exceed the gross receipts of X Corporation's tennis academy for that period.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its tennis academy as a separate and distinct trade or business, X Corporation must use a principal method under paragraph (a)(3) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal method in accordance with paragraph (a)(5) of this section. Because on the date of distribution or transfer the tennis academy operated by T Corporation is larger than the tennis academy operated by X Corporation, the principal method for the overall method of accounting for the combined tennis academy business is the accrual method used by T Corporation's tennis academy immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal method for the overall method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the method of accounting for its tennis academy to the accrual method. Because X Corporation will operate the golf academy as a separate trade or business, under paragraph (a)(2) of this section X Corporation must continue to use the accrual method that it used immediately prior to the date of distribution or transfer as the carryover method for the golf academy. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use the carryover method.

Example (10). *Principal method determination with multiple component trades or businesses*—(i) *Facts*. The facts are the same as in *Example* (9), except that after the date of distribution or transfer X Corporation will not operate its golf academy as a trade or business that is separate and distinct from the tennis academy. In addition, X Corporation's component trades or businesses are larger than T Corporation's component trade or business: (1) the adjusted bases of the assets of X Corporation's tennis academy and golf academy businesses, in the aggregate, exceed the adjusted bases of the assets held by T Corporation's tennis academy; and (2) the gross receipts for the representative period of X Corporation's tennis academy and golf academy businesses, in the aggregate, exceed the gross receipts in T Corporation's tennis academy.

(ii) *Conclusion*. Because on the date of distribution or transfer T Corporation's tennis academy is not larger than X Corporation's combined tennis academy and golf academy, the principal method for the overall method of accounting is the method of accounting used by the component trades or businesses of X Corporation that will be combined with T Corporation's component trade or business on that date. Because on the date of distribution or transfer X Corporation operates two component trades or businesses with different overall methods of accounting that will be integrated after the date of distribution or transfer, X Corporation may choose under paragraph (c)(2) of this section which overall method (and any special method of accounting) used by its component trades or businesses will be the principal method. X Corporation may choose to use either the accrual method used by the golf academy or the cash receipts and disbursements method used by its tennis academy as the principal method after the date of distribution or transfer, if either method is a permissible method. In accordance with paragraph (d)(1) of this section, X Corporation must change T Corporation's overall method of accounting to the principal method. Under paragraph (a)(3) of this section, X Corporation also must change either its golf academy business or its tennis academy business, depending on which principal method X Corporation selects, to the principal method.

(d) *Procedures for changing a method of accounting*—(1) *Change made to principal method under paragraph (a)(3) of this section*—(i) *Section 481(a) adjustment*—(A) *In general.* An acquiring corporation that changes its method of accounting or the distributor or transferor corporation's method of accounting under paragraph (a)(3) of this section does not need to secure the Commissioner's consent to use the principal method. To the extent the use of a principal method constitutes a change in method of accounting, the change in method is treated as a change initiated by the acquiring corporation for purposes of section 481(a)(2). Any change to a principal method, whether the change relates to a trade or business of the acquiring corporation or a trade or business of the distributor or transferor corporation, must be reflected on the acquiring corporation's federal income tax return for the taxable year that includes the date of distribution or transfer. The amount of the section 481(a) adjustment and the adjustment period, if any, necessary to implement a change to the principal method are determined under § 1.446–1(e) and the applicable administrative procedures that govern voluntary changes in methods of accounting under section 446(e). If the Internal Revenue Code, the Income Tax Regulations, or administrative procedures require that a method of accounting be implemented on a cut-off basis, the acquiring corporation must implement the change on a cut-off basis as of the date of distribution or transfer on its federal income tax return for the taxable year that includes the date of distribution or transfer. If the Internal Revenue Code, the Income Tax Regulations, or administrative procedures require a section 481(a) adjustment, the acquiring corporation must determine the section 481(a) adjustment and include the appropriate amount of the section 481(a) adjustment on its federal income tax return for the taxable year that includes the date of distribution or transfer and subsequent taxable year(s), as necessary. This adjustment is determined by the acquiring corporation as of the beginning of the day that is immediately after the date of distribution or transfer.

(B) *Example.* The following example illustrates the rules of this paragraph (d)(1)(i):

Example. X Corporation uses the overall cash receipts and disbursements method of accounting, and T Corporation uses an overall accrual method of accounting. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. X Corporation determines that under the rules of paragraph (c)(1) of this section X Corporation must change the method of accounting for the business acquired from T Corporation to the cash receipts and disbursements method. X Corporation will determine the section 481(a) adjustment pertaining to the change to the cash receipts and disbursements method by consolidating the adjustments (whether the amounts thereof represent increases or decreases in items of income or deductions) arising with respect to balances in the various accounts, such as accounts receivable, as of the beginning of the day that immediately follows the day on which X Corporation acquires the assets of T Corporation. X Corporation will reflect this adjustment, or an appropriate part thereof, on its federal income tax return for the taxable year that includes the date of distribution or transfer.

(ii) *Audit protection.* Notwithstanding any other provision in any other Income Tax Regulation or administrative procedure, no audit protection is provided for any change in method of accounting under paragraph (d)(1) of this section.

(iii) *Other terms and conditions.* Except as otherwise provided in this section, other terms and conditions provided in § 1.446–1(e) and the applicable administrative procedures for voluntary changes in method of accounting under section 446(e) apply to a change in method of accounting under this section. Thus, for example, if the administrative procedures for a particular change in method of accounting have a term and condition that provides for the acceleration of the section 481(a) adjustment period, this term and condition applies to a change made under this paragraph (d)(1). However, any scope limitation in the applicable administrative procedures will not apply for purposes of making a change under this paragraph (d)(1). For example, if the administrative procedures provide as a limitation that an identical change in method of accounting is barred for a period of years, this limitation will not bar a change to the principal method made under this section.

(2) *Change made to a method of accounting under paragraph (a)(4) or (a)(5) of this section*—(i) *In general.* A party to a section 381(a) transaction that changes a method of accounting under either paragraph (a)(4) or paragraph (a)(5) of this section must follow the provisions of § 1.446–(1)(e) and the applicable administrative procedures, including scope limitations, for voluntary changes in method of accounting under section 446(e), except as provided in paragraphs (d)(2)(ii) and (d)(2)(iii) of this section. An application on Form 3115, ''Application for Change in Accounting Method,'' filed with the IRS to change a method of accounting under this paragraph (d)(2) should be labeled ''Filed under section 381(c)(4)'' at the top.

(ii) *Final year limitation.* Any scope limitation relating to the final year of a trade or business will not apply to a taxpayer that changes its method of accounting in the final year of a trade or business that is terminated as the result of a section 381(a) transaction.

(iii) *Time to file.* Under the authority of § 1.446–1(e)(3)(ii), for a change in method of accounting requiring advance consent, the application for a change in method of accounting (for example, Form 3115) must be filed with the IRS on or before the later of—

(A) The due date for filing a Form 3115 as specified in § 1.446–1(e), for example, the last day of the taxable year in which the distribution or transfer occurred, or

(B) The earlier of—

(*1*) The day that is 180 days after the date of distribution or transfer, or

(*2*) The day on which the acquiring corporation files its federal income tax return for the taxable year in which the distribution or transfer occurred.

(e) *Rules and procedures*—(1) *No method of accounting.* If a party to a section 381(a) transaction is not using a method of accounting, does not have a method of accounting for a particular item, or came into existence as a result of the transaction, the party will not be treated as having a method of accounting different from that used by another party to the section 381(a) transaction.

(2) *Elections and adoptions allowed.* If an election does not require the Commissioner's consent, an acquiring corporation or a distributor or transferor corporation is not precluded from making any election that is otherwise permissible for the taxable year that includes the date of distribution or transfer. For purposes of this section, a corporation shall be deemed as having made any election as of the first day of the taxable year that includes the date of distribution or transfer. Similarly, where adoption is permissible, an acquiring corporation or a distributor or transferor corporation may adopt any permissible method of accounting for the taxable year that includes the date of distribution or transfer.

(3) *Elections continue after section 381(a) transaction*—(i) *General rule.* An acquiring corporation is not required to renew any election not otherwise requiring renewal and previously made by it or by a distributor or transferor corporation for a carryover method or a principal method if the acquiring corporation uses the method after the section 381(a) transaction. If the acquiring corporation uses a method after the date of distribution or transfer, an election made by the acquiring corporation or by a distributor or transferor corporation for that method that was in effect on the date of distribution or transfer continues after the section 381(a) transaction as though the distribution or transfer had not occurred.

(ii) *Example.* The following example illustrates the rules of this paragraph (e)(3):

Example. The acquiring corporation, X Corporation, previously elected to amortize bond premium under section 171. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. X Corporation determines under the rules of paragraph (c)(1) of this section that X Corporation's method of amortizing bond premium is the principal method. After the date of distribution or transfer, X Corporation is not required to renew its bond premium amortization election and is bound by it. Additionally, X Corporation would not be required to renew its election to amortize bond premium if the method were the carryover method under paragraph (a)(2) of this section.

(4) *Appropriate times for certain determinations*—(i) *Determining the method of accounting.* The method of accounting used by a party to a section 381(a) transaction on the date of distribution or transfer is the method of accounting used by that party as of the end of the day that is immediately prior to the date of distribution or transfer.

(ii) *Determining whether there are separate and distinct trades or businesses after the date of distribution or transfer.* Whether an acquiring corporation will operate the trades or businesses of the parties to a section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer will be determined as of the date of distribution or transfer based upon the facts and circumstances. Intent to combine books and records of the trades or businesses may be demonstrated by contemporaneous records and documents or by other objective evidence that reflects the acquiring corporation's ultimate plan of operation, even though the actual combination of the books and records may extend beyond the end of the taxable year that includes the date of distribution or transfer.

(5) *Representative period for aggregating gross receipts.* The representative period for measuring gross receipts is generally the 12 consecutive months preceding the date of distribution or transfer. If a component trade or business was not in existence for the 12 consecutive months preceding the date of distribution or transfer, then all component trades or businesses of each integrated trade or business will compare their gross receipts for the period that such trade or business was in existence. For example, if the acquiring corporation's component trade or business was formed in August and the date of distribution or transfer occurred in December of the same year, the gross receipts for those five months will be compared with the gross receipts of the other component trades or businesses for the same period.

(6) *Establishing a method of accounting.* A method of accounting used by the distributor or transferor corporation immediately prior to the date of distribution or transfer that continues to be used by the acquiring corporation after the date of distribution or transfer is an established method of accounting for purposes of section 446(e), whether or not such method is proper or is permitted under the Internal Revenue Code or any applicable Income Tax Regulations.

(7) *Other applicable provisions.* This section does not preempt any other provision of the Internal Revenue Code or the Income Tax Regulations that is applicable to the acquiring corporation's circumstances. For example, income, deductions, credits, allowances, and exclusions may be allocated among the parties to a section 381(a) transaction and other taxpayers under sections 269 and 482, if appropriate. Similarly, transfers of contracts accounted for using a long-term contract method of accounting are governed by the rules provided in § 1.460–4(k). Further, if other paragraphs of section 381(c) apply for purposes of determining the methods of accounting to be used following the date of distribution or transfer, section 381(c)(4) and this § 1.381(c)(4)–1 will not apply to the tax treatment of the items. For example, this section does not apply to inventories that an acquiring corporation obtains in a transaction to which section 381(a) applies. Instead, the rules of section 381(c)(5) govern the inventory method to be used by the acquiring corporation after the distribution or transfer. Similarly, if the acquiring corporation assumes an obligation of the distributor or transferor corporation that gives rise to a liability after the date of distribution or transfer and to which § 1.381(c)(16)–1 applies, the deductibility of the item is determined under this section only after the rules of section 381(c)(16) are applied.

(8) *Character of items of income and deduction.* After the date of distribution or transfer, items of income and deduction have the same character in the hands of the acquiring corporation as they would have had in the hands of the distributor or transferor corporation if no distribution or transfer had occurred.

(9) *Method of accounting selected by project or job.* If other sections of the Internal Revenue Code, Income Tax Regulations, or other administrative guidance permit an acquiring corporation to elect a method of accounting on a project-by-project, job-by-job, or other similar basis, then for purposes of this section the method elected with respect to each project or job is the established method only for that project or job. For example, the election under section 460 to classify a contract to perform both manufacturing and construction activities as a long-term construction contract if at least 95 percent of the estimated total allocable contract costs are reasonably allocated to the construction activities is made on a contract-by-contract basis. Accordingly, the method of accounting previously elected for a project or job generally continues after the date of distribution or transfer. However, if the trades or businesses of the parties to a section 381(a) transaction are not operated as separate and distinct trades or businesses after the date of distribution or transfer, and two or more of the parties to the section 381(a) transaction previously worked on the same project or job and used different

methods of accounting for the project or job immediately before the distribution or transfer, then the acquiring corporation must determine the principal method for that project or job under paragraph (c) of this section and make changes, if necessary, to the principal method in accordance with paragraph (d)(1) of this section.

(10) *Impermissible method of accounting.* This section does not limit the Commissioner's ability under section 446(b) to determine whether a taxpayer's method of accounting is an impermissible method or otherwise fails to clearly reflect income. For example, an acquiring corporation may not use the method of accounting determined under paragraph (a)(2) of this section if the method fails to clearly reflect the acquiring corporation's income within the meaning of section 446(b).

(f) *Effective/applicability date.* This section applies to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

■ **Par. 4.** Section 1.381(c)(5)–1 is revised to read as follows:

§ 1.381(c)(5)–1 Inventory method.

(a) *Introduction*—(1) *Purpose.* This section provides guidance regarding the inventory method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(5) apply and how to implement any associated change in method of accounting. See § 1.381(c)(4)–1 for guidance regarding the method of accounting or combination of methods (other than inventory and depreciation methods) an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(4) apply. See § 1.381(c)(6)–1 for guidance regarding the depreciation method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(6) apply.

(2) *Carryover method requirement for separate and distinct trades or businesses.* In a transaction to which section 381(a) applies, if an acquiring corporation continues to operate a trade or business of the parties to the section 381(a) transaction as a separate and distinct trade or business after the date of distribution or transfer, the acquiring corporation must use a carryover method as defined in paragraph (b)(4) of this section for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or the acquiring corporation changes the carryover method in accordance with paragraph (a)(5) of this section. The acquiring corporation need not secure the Commissioner's consent to continue a carryover method.

(3) *Principal method requirement for trades or businesses not operated as separate and distinct trades or businesses.* In a transaction to which section 381(a) applies, if an acquiring corporation does not operate the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer, the acquiring corporation must use a principal method determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or the acquiring corporation changes the principal method in accordance with paragraph (a)(5) of this section. The acquiring corporation must change to a principal method in accordance with paragraph (d)(1) of this section for each integrated trade or business and need not secure the Commissioner's consent to use a principal method.

(4) *Carryover method or principal method not a permissible method.* If a carryover method or principal method is not a permissible inventory method, the acquiring corporation must secure the Commissioner's consent to change to a permissible inventory method as provided in paragraph (d)(2) of this section. If the acquiring corporation must use a single inventory method for a particular type of goods after the date of distribution or transfer regardless of the number of separate and distinct trades or businesses operated on that date, the acquiring corporation must use the principal method for that type of goods as determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under this paragraph (a)(4) or the acquiring corporation changes the principal method in accordance with paragraph (a)(5) of this section.

(5) *Voluntary change.* Any party to a section 381(a) transaction may request permission under section 446(e) to change an inventory method for the taxable year in which the transaction occurs or is expected to occur. For trades or businesses that will not operate as separate and distinct trades or businesses after the date of distribution or transfer, a change in method of accounting for the taxable year that includes that date will be granted only if the requested inventory method is the method that the acquiring corporation must use after the date of distribution or transfer. The time and manner of obtaining the Commissioner's consent to change to a different inventory method is described in paragraph (d)(2) of this section.

(6) *Examples.* The following examples illustrate the rules of this paragraph (a). Unless otherwise noted, the carryover method is a permissible inventory method.

Example (1). *Carryover method for separate and distinct trades or businesses after the date of distribution or transfer*—(i) *Facts.* X Corporation manufactures radios and television sets. X Corporation uses the first-in, first-out (FIFO) method of inventory identification, the cost method of valuing its inventories, and capitalizes inventory costs in accordance with section 263A. T Corporation manufactures washing machines and dryers. T Corporation uses the last-in, first-out (LIFO) method of inventory identification, the cost method of valuing its inventories, and capitalizes inventory costs under section 263A using methods other than those used by X Corporation. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates its radio and television manufacturing business as a trade or business that is separate and distinct from its washing machines and dryers manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation operates its manufacturing businesses as separate and distinct trades or businesses, under paragraph (a)(2) of this section X Corporation must use the carryover methods for each continuing trade or business, unless either the carryover methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover methods in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(4) of this section, the carryover methods for the radios and television sets manufacturing business are the FIFO method, the cost basis of valuation, and X Corporation's methods of accounting for section 263A costs immediately prior to the date of distribution or transfer. The carryover methods for the washing machines and dryers manufacturing business are the LIFO method, the cost basis of valuation, and T Corporation's methods of accounting for section 263A costs immediately prior to the date of distribution or transfer. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use any carryover method.

Example (2). *Carryover method not permissible*—(i) *Facts.* X Corporation manufactures food and beverages and uses the FIFO method of inventory identification, the cost method of valuing its inventories, and capitalizes costs in accordance with section 263A. T Corporation sells sporting equipment. T Corporation uses the FIFO method of inventory identification and the cost method of valuing its inventories. T Corporation does not capitalize costs under section 263A because it meets the small reseller exception under section 263A. X

Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates the food and beverages business as a trade or business that is separate and distinct from the sporting equipment business, and X Corporation does not qualify for the small reseller exception under section 263A for its sporting equipment business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation operates the food and beverages business as a separate and distinct trade or business, under paragraph (a)(2) of this section X Corporation must use the carryover methods for each continuing trade or business, unless either the carryover methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover methods in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(4) of this section, the carryover methods for the food and beverages business are the FIFO method, the cost basis of valuation, and X Corporation's methods of capitalizing costs under section 263A immediately prior to the date of distribution or transfer. The carryover methods for the sporting equipment business are the FIFO method and the cost basis of valuation. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use any carryover method. However, because X Corporation does not qualify for the small reseller exception under section 263A for its sporting equipment business, X Corporation's method of not capitalizing additional section 263A costs is an impermissible carryover method under paragraph (a)(4) of this section. X Corporation must secure the Commissioner's consent to change to a permissible method of capitalizing costs under section 263A for the sporting equipment business as provided in paragraph (d)(2) of this section.

(b) *Definitions.* (1) *Inventory method.* An inventory method is a method of accounting used to account for merchandise on hand (including finished goods, work in process, and raw materials) at the beginning of a year for purposes of computing taxable income for that year. The term includes not only the method for identifying inventory, for example, the FIFO inventory method or the LIFO inventory method, but also all other methods necessary to account for merchandise.

(2) *Adoption of a method of accounting.* Adoption of a method of accounting has the same meaning as provided in § 1.446–1(e)(1).

(3) *Change in method of accounting.* A change in method of accounting has the same meaning as provided in § 1.446–1(e)(2).

(4) *Carryover method.* A carryover method is an inventory method that each party to a section 381(a) transaction uses for each separate and distinct trade or business immediately prior to the date of distribution or transfer.

(5) *Principal method.* A principal method is an inventory method that is determined under paragraph (c) of this section.

(6) *Permissible method of accounting.* A permissible method of accounting is a method of accounting that is proper or permitted under the Internal Revenue Code or any applicable Income Tax Regulations.

(7) *Acquiring corporation.* An acquiring corporation has the same meaning as provided in § 1.381(a)–1(b)(2).

(8) *Distributor corporation.* A distributor corporation means the corporation, foreign or domestic, that distributes its assets to another corporation described in section 332(b) in a distribution to which section 332 (relating to liquidations of subsidiaries) applies.

(9) *Transferor corporation.* A transferor corporation means the corporation, foreign or domestic, that transfers its assets to another corporation in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if—

(i) The transfer is in connection with a reorganization described in section 368(a)(1)(A), (a)(1)(C), or (a)(1)(F), or

(ii) The transfer is in connection with a reorganization described in section 368(a)(1)(D) or (a)(1)(G), provided the requirements of section 354(b) are met.

(10) *Parties to the section 381(a) transaction.* Parties to the section 381(a) transaction means the acquiring corporation and the distributor or transferor corporation that participate in a transaction to which section 381(a) applies.

(11) *Date of distribution or transfer.* The date of distribution or transfer has the same meaning as provided in section 381(b)(2) and § 1.381(b)–1(b).

(12) *Separate and distinct trades or businesses.* Separate and distinct trades or businesses has the same meaning as provided in § 1.446–1(d).

(13) *Audit protection.* Audit protection means, for purposes of paragraph (d)(1) of this section, that the IRS will not require an acquiring corporation that is required to change a method of accounting under paragraph (a)(3) of this section to change that method for a taxable year ending prior to the taxable year that includes the date of distribution or transfer.

(14) *Section 481(a) adjustment.* The section 481(a) adjustment means an adjustment that must be taken into account as required under section 481(a) to prevent amounts from being duplicated or omitted when the taxable income of an acquiring corporation is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year.

(15) *Cut-off basis.* A cut-off basis means a manner in which a change in method of accounting is made without a section 481(a) adjustment and under which only the items arising after the beginning of the year of change (or, in the case of a change made under paragraph (d)(1) of this section, after the date of distribution or transfer) are accounted for under the new method of accounting. When it implements the change on a cut-off basis, a taxpayer using the LIFO inventory method to identify its inventory goods that makes a change in method of accounting within the LIFO inventory method from one LIFO method or sub-method to another LIFO method or sub-method uses the new LIFO inventory method to determine its current-year cost and base-year cost of ending inventories for the year of change, but does not recompute the cost of beginning inventories for the year of change using the new LIFO inventory method.

(16) *Adjustment period.* The adjustment period means the number of taxable years for taking into account the section 481(a) adjustment required as a result of a change in method of accounting.

(17) *Component trade or business.* A component trade or business is a trade or business of a party to the section 381(a) transaction that will be combined and integrated with a trade or business of the other party to the section 381 transaction. See paragraph (e)(7)(ii) of this section for the determination of whether a trade or business is operated as a separate and distinct trade or business after the date of distribution or transfer.

(c) *Principal method*—(1) *In general.* For each integrated trade or business, the principal method for a particular type of goods is generally the inventory method used by the component trade or business of the acquiring corporation immediately prior to the date of distribution or transfer for that type of goods. If, however, on the date of distribution or transfer the component trade or business of the distributor or transferor corporation holds more inventory of a type of goods than the component trade or business of the acquiring corporation, the principal method for such goods is the inventory method used by the component trade or business of the distributor or transferor corporation immediately prior to that date. For each integrated trade or business, the component trade or business of the distributor or transferor corporation holds more inventory if, for a particular type of goods, the aggregate of the fair market value of the goods held by each component trade or business of the distributor or transferor corporation exceeds the aggregate of the fair market value of the goods held by each component trade or business of the acquiring corporation immediately prior to the date of distribution or transfer. Alternatively, as a simplifying convention, the acquiring corporation may elect to apply the preceding sentence to the aggregate fair market value of the entire inventories, held by each component trade or business of the acquiring corporation and each component trade or business of the distributor or transferor corporation, that will be integrated after the date of distribution or transfer. If the component trade or business with the larger aggregate fair market value of the entire inventories does not have an inventory method for a particular type of goods immediately prior to the date of distribution or transfer, the principal method for that type of goods is the inventory method used by the component trade or business that does have an inventory method for that type of goods.

(2) *Multiple component trades or businesses with different principal methods.* If a party to the section 381(a) transaction has multiple component trades or businesses and more than one principal inventory method for a particular type of goods, then the acquiring corporation may choose which of the inventory methods used by such component trades or businesses will be the principal method of the integrated trade or business. The acquiring corporation must choose a principal method that is a permissible method of accounting. In general, a change to a principal method in a transaction to which section 381(a) and paragraph (a)(3) of this section apply is made under paragraph (d)(1) of this section.

(3) *Examples.* The following examples illustrate the rules of this paragraph (c). Unless otherwise noted, the principal method is a permissible inventory method.

Example (1). *Principal methods are the methods used by the acquiring corporation*—(i) *Facts.* X Corporation and T Corporation each manufacture tennis equipment. X Corporation's manufacturing business uses the FIFO method of inventory identification, the cost method of valuing inventories, and allocates indirect costs to the property produced using the burden rate method provided in § 1.263A–1(f)(3)(i). T Corporation's manufacturing business uses the LIFO method of inventory identification, the cost method of valuing its inventories, and allocates indirect costs to the property it produces using the standard cost method provided in § 1.263A–1(f)(3)(ii). X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. The fair market value of each particular type of goods held by X Corporation's manufacturing business immediately prior to the date of distribution or transfer exceeds the fair market value of each particular type of goods held by T Corporation's manufacturing business on that date. After the date of distribution or transfer, X Corporation will not operate its manufacturing business as a trade or business that is separate and distinct from T Corporation's manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its manufacturing business as a separate and distinct trade or business, X Corporation must use the principal methods under paragraph (a)(3) of this section, unless either the principal methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal methods in accordance with paragraph (a)(5) of this section. The fair market value of each particular type of goods held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer does not exceed the fair market value of each particular type of goods held by X Corporation's manufacturing business on that date. Because on the date of distribution or transfer T Corporation's manufacturing business does not hold more inventory than X Corporation's manufacturing business, the principal methods are the FIFO method of inventory identification, the cost method of valuation, and X Corporation's method of allocating indirect costs under section 263A using the burden rate method. X Corporation need not secure the Commissioner's consent to use these methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business acquired from T Corporation to the principal methods.

Example (2). *Principal methods are the methods used by the acquiring corporation*—(i) *Facts.* The facts are the same as in *Example* (1), except that the fair market value of each particular type of goods held by X Corporation's manufacturing business immediately prior to the date of distribution or transfer is identical to the fair market value of each particular type of goods held by T Corporation's manufacturing business on that date.

(ii) *Conclusion.* The result is the same as in *Example* (1). The principal methods are the FIFO method of inventory identification, the cost method of valuation, and X Corporation's method of allocating indirect costs under section 263A using the burden rate method. X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business acquired from T Corporation to the principal methods.

Example (3). *Principal methods are the methods used by the distributor or transferor corporation*—(i) *Facts.* The facts are the same as in *Example* (1), except that the fair market value of each particular type of goods held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer exceeds the fair market value of each particular type of goods held by X Corporation's manufacturing business on that date.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its manufacturing business as a separate and distinct trade or business, X Corporation must use the principal methods under paragraph (a)(3) of this section, unless either the principal methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal methods in accordance with paragraph (a)(5) of this section. The fair market value of each particular type of goods held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer exceeds the fair market value of each particular type of goods held by X Corporation's manufacturing business on that date. Because on the date of distribution or transfer T Corporation's manufacturing business holds more inventory than X Corporation's manufacturing business, the principal methods are the LIFO method of inventory identification, the cost method of valuation, and T Corporation's method of allocating indirect costs under section 263A using the standard cost method. X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business operated by X Corporation prior to the date of distribution or transfer to the principal methods.

Example (4). *Voluntary change allowable*—(i) *Facts.* The facts are the same as in *Example* (1), except that T Corporation wants to discontinue using the LIFO method for its manufacturing business and change to the FIFO method for the taxable year in which the section 381(a) transaction occurs or is expected to occur.

(ii) *Conclusion.* Under paragraph (a)(5) of this section, the Commissioner will grant a request to change a method of accounting for the taxable year that includes the date of distribution or transfer only if the requested method is the method that the acquiring corporation must use after the date of distribution or transfer. The Commissioner will consent to a request by T Corporation to change to the FIFO method for the taxable year in which the section 381(a) transaction occurs or is expected to occur because X Corporation will use this method after the date of distribution or transfer.

Example (5). *Principal method determination when larger component trade or business does not have a method of* *accounting for a particular type of goods*—(i) *Facts.* The facts are the same as in *Example* (1), except that T Corporation's manufacturing business has a particular type of goods that is not held by X Corporation's manufacturing business.

(ii) *Conclusion.* The result is similar to *Example* (1). In general, the principal methods are the FIFO method of inventory identification, the cost method of valuation, and X Corporation's method of allocating indirect costs to the property produced using the burden rate method. X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business acquired from T Corporation to the principal methods. Under paragraph (c) of this section, the principal methods for the particular type of goods held only by T Corporation's manufacturing business are the LIFO method of inventory identification, the cost method of valuation, and T Corporation's method of allocating indirect costs to the property it produces using the standard cost method. X Corporation must determine whether the principal methods for the type of goods previously held by T Corporation are permissible given that such methods are different than the principal methods that must be used by X for all other goods. If X Corporation's use of the standard cost method would be impermissible after the date of distribution or transfer, X Corporation must change to a permissible method under section 263A for those goods in accordance with paragraph (a)(4) of this section.

Example (6). *Inventory convention elected*—(i) *Facts.* X Corporation manufactures planes and T Corporation manufactures planes and communications satellites. X Corporation's manufacturing business uses the FIFO method of inventory identification and values its inventories at cost or market, whichever is lower, while T Corporation's manufacturing business uses the LIFO method of inventory identification and values its inventories at cost. X Corporation's manufacturing business and T Corporation's manufacturing business, use the same methods to capitalize costs under section 263A. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. In lieu of determining the fair market value of each particular type of goods held on the date of distribution or transfer, X Corporation elects to value the entire inventories of its manufacturing business and the entire inventories of T Corporation's manufacturing business in accordance with paragraph (c)(1) of this section. The fair market value of the inventory held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer does not exceed the fair market value of the inventory held by X Corporation's manufacturing business on that date. After the date of distribution or transfer, X Corporation will not operate its manufacturing business as a trade or business that is separate and distinct from T Corporation's manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its manufacturing business as a separate and distinct trade or business, X Corporation must use the principal methods under paragraph (a)(3) of this section, unless either the principal methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal methods in accordance with paragraph (a)(5) of this section. The fair market value of the entire inventory held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer does not exceed the fair market value of the entire inventory of X Corporation's manufacturing business on that date. Because on the date of distribution or transfer T Corporation's manufacturing business does not hold more inventory than X Corporation's manufacturing business, the principal methods are the FIFO method, the cost or market, whichever is lower, method of valuation, and X Corporation's method of capitalizing costs under section 263A on the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business acquired from T Corporation to the principal methods.

Example (7). *Principal method determination with a combined trade or business and a separate and distinct trade or business*—(i) *Facts.* X Corporation manufactures tennis equipment in a trade or business that is separate and distinct from its trade or business of manufacturing golf equipment. X Corporation uses the FIFO method of inventory identification for its tennis equipment and the LIFO method of inventory identification for its golf equipment. X Corporation values the goods in both inventories at cost and allocates indirect costs to the property produced using the burden rate method provided in § 1.263A–1(f)(3)(i). T Corporation manufactures tennis equipment. T Corporation's manufacturing business uses the FIFO method of inventory identification, values inventories at cost, and allocates indirect costs to the property it produces using the standard cost method provided in § 1.263A–1(f)(3)(ii). X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. Immediately prior to the date of distribution or transfer, the fair market value of T Corporation's inventories in the tennis equipment manufacturing business exceeds the fair market value of the inventories held by X Corporation's tennis equipment manufacturing business. After the date of distribution or transfer, X Corporation will not operate its tennis equipment manufacturing business as a trade or business that is separate and distinct from T Corporation's tennis equipment manufacturing business, but X Corporation will operate its golf equipment manufacturing business as a trade or business that is separate and distinct from the tennis equipment manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its tennis equipment manufacturing business as a separate and distinct trade or business, X Corporation must use the principal methods under paragraph (a)(3) of this section, unless either the principal methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal methods in accordance with paragraph (a)(5) of this section. Under paragraph (c)(1) of this section, X Corporation elects to compare the fair market values of the entire inventories of the component trades or businesses on the date of distribution or transfer to determine whether T Corporation holds more inventory than X Corporation. The fair market value of the inventory held by T Corporation's tennis equipment manufacturing business exceeds the fair market value of the tennis equipment held by X Corporation's tennis equipment manufacturing business. Because on the date of distribution or transfer T Corporation's tennis equipment manufacturing business holds more inventory than X Corporation's tennis equipment manufacturing business, the principal methods for the combined tennis equipment business are the FIFO method of inventory identification, the cost basis of valuation, and T Corporation's methods of allocating indirect costs under section 263A using the standard cost method provided in § 1.263A–1(f)(3)(ii). X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the methods of accounting for its tennis equipment manufacturing business to the principal methods. Under paragraph (a)(2) of this section, because X Corporation will operate the golf equipment manufacturing business as a separate trade or business, for the inventories held by the golf equipment manufacturing business X Corporation must continue to use the LIFO method of inventory identification, use the cost basis of valuation, and allocate indirect costs under section 263A using the burden rate method provided in § 1.263A–1(f)(3)(i). There are no changes in method of accounting for the golf manufacturing business, and X Corporation need not secure the Commissioner's consent to use these carryover methods.

Example (8). *Principal method determination with multiple component trades or businesses*—(i) *Facts.* The facts are the same as in *Example* (7), except that after the date of distribution or transfer X Corporation will not operate the golf equipment manufacturing business as a trade or business that is separate and distinct from the tennis equipment manufacturing business. In addition, the fair market value of the inventories of X Corporation's tennis equipment manufacturing business and golf equipment manufacturing business, in the aggregate, exceed the fair market value of the inventories of T Corporation's tennis equipment manufacturing business.

(ii) *Conclusion.* Because on the date of distribution or transfer T Corporation's tennis equipment manufacturing business does not hold more inventory than X Corporation's tennis equipment manufacturing business and golf equipment manufacturing business, in the aggregate, the principal method for identifying inventory is the method used by X Corporation's component trade or business on the date of distribution or transfer. However, because on the date of distribution or transfer X Corporation operates two separate and distinct trades or businesses with different inventory identification methods that will be combined after the date of distribution or transfer, X Corporation may choose under paragraph (c)(2) of this section which method used by its component trades or businesses will be the principal method. After the date of distribution or transfer, X Corporation may use either the FIFO method of inventory identification used by the tennis equipment manufacturing business or the LIFO method of inventory identification used by the golf equipment manufacturing business as the principal method of identification, if either method is a permissible method. For the integrated trade or business, X Corporation will use the cost method of valuation and allocate indirect costs under section 263A using the burden rate method provided in § 1.263A–1(f)(3)(i). In accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods of T Corporation's manufacturing business to the principal methods. Under paragraph (a)(3) of this section, X Corporation also must change either its golf equipment manufacturing business or its tennis equipment manufacturing business, depending on which principal method X Corporation selects, to the principal method.

(d) *Procedures for changing a method of accounting*—(1) *Change made to principal method under paragraph (a)(3) of this section*—(i) *Section 481(a) adjustment*—(A) *In general.* An acquiring corporation that changes its method of accounting or the distributor or transferor corporation's method of accounting under paragraph (a)(3) of this section does not need to secure the Commissioner's consent to use a principal method. To the extent the use of a principal method constitutes a change in method of accounting, the change in method is treated as a change initiated by the acquiring corporation for purposes of section 481(a)(2). Any change to a principal method, whether the change relates to a trade or business of the acquiring corporation or a trade or business of the distributor or transferor corporation, must be reflected on the acquiring corporation's federal income tax return for the taxable year that includes the date of distribution or transfer. The amount of the section 481(a) adjustment and the adjustment period, if any, necessary to implement a change to the principal method are determined under § 1.446–1(e) and the applicable administrative procedures that govern voluntary changes in methods of accounting under section 446(e). If the Internal Revenue Code, the Income Tax Regulations, or administrative procedures require that a method of accounting be implemented on a cut-off basis, the acquiring corporation must implement the change, on a cut-off basis as of the date of distribution or transfer, on its federal income tax return for the taxable year that includes the date of distribution or transfer. If the Internal Revenue Code, the Income Tax Regulations, or administrative procedures require a section 481(a) adjustment, the acquiring corporation must determine the section 481(a) adjustment and include the appropriate amount of the section 481(a) adjustment on its federal income tax return for the taxable year that includes the date of distribution or transfer and subsequent taxable year(s), as necessary. This adjustment is determined by the acquiring corporation as of the beginning of the day that is immediately after the date of distribution or transfer.

(B) *Example.* The following example illustrates the rules of this paragraph (d)(1)(i):

Example. X Corporation uses the FIFO method of inventory identification, and T Corporation uses the LIFO method of inventory identification. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. X Corporation determines that under the rules of paragraph (c)(1) of this section, X Corporation must change the inventory method for the business acquired from T Corporation to the FIFO method. X Corporation will determine the section 481(a) adjustment pertaining to the change to the FIFO method (whether the amounts thereof represent increases or decreases in income) as of the beginning of the day that immediately follows the day on which X Corporation acquires the inventory of T Corporation. X Corporation will reflect this adjustment, or an appropriate part thereof, on its federal income tax return for the taxable year that includes the date of distribution or transfer.

(ii) *Audit protection.* Notwithstanding any other provision in any other Income Tax Regulation or administrative procedure, no audit protection is provided for any change in method of accounting under paragraph (d)(1) of this section.

(iii) *Other terms and conditions.* Except as otherwise provided in this section, other terms and conditions provided in § 1.446–1(e) and the applicable administrative procedures for voluntary changes in method of accounting under section 446(e) apply to a change in method of accounting under this section. Thus, for example, if the administrative procedures for a particular change in method of accounting have a term and condition that provides for the acceleration of the section 481(a) adjustment period, this term and condition applies to a change made under this paragraph (d)(1). However, any scope limitation in the applicable administrative procedures will not apply for purposes of making a change under this paragraph (d)(1). For example, if the administrative procedures provide as a limitation that an identical change in method of accounting is barred for a period of years, this limitation will not bar a change to the principal method made under this section.

(2) *Change made to a method of accounting under paragraph (a)(4) or (a)(5) of this section*—(i) *In general.* A party to a section 381(a) transaction that changes a method of accounting under either paragraph (a)(4) or paragraph (a)(5) of this section must follow the provisions of § 1.446–(1)(e) and the applicable administrative procedures, including scope limitations, for voluntary changes in method of accounting under section 446(e), except as provided in paragraphs (d)(2)(ii) and (d)(2)(iii) of this section. An application on Form 3115, ''Application for Change in Accounting Method,'' filed with the IRS to change a method of accounting under this paragraph (d)(2) should be labeled ''Filed under section 381(c)(5)'' at the top.

(ii) *Final year limitation.* Any scope limitation relating to the final year of a trade or business will not apply to a taxpayer that changes its method of accounting in the final year of a trade or business that is terminated as the result of a section 381(a) transaction.

(iii) *Time to file.* Under the authority of § 1.446–1(e)(3)(ii), for a change in method of accounting requiring advance consent, the application for a change in method of accounting (for example, Form 3115), must be filed with the IRS on or before the later of—

(A) The due date for filing a Form 3115 as specified in § 1.446–1(e), for example, the last day of the taxable year in which the distribution or transfer occurred, or

(B) The earlier of—

(*1*) The day that is 180 days after the date of distribution or transfer, or

(*2*) The day on which the acquiring corporation files its federal income tax return for the taxable year in which the distribution or transfer occurred.

(e) *Rules and procedures*—(1) *Inventory method selected for a particular type of goods.* If other sections of the Internal Revenue Code or Income Tax Regulations allow a taxpayer to elect an inventory method for a particular type of goods, the method elected with respect to those goods is the established inventory method only for those goods. For example, an election to use the LIFO inventory method to identify specified goods in inventory, such as certain products in finished goods, is the inventory method only for those products.

(2) *No method of accounting.* If a party to a section 381(a) transaction is not using an inventory method, does not have an inventory method for a particular type of goods, or came into existence as a result of the transaction, the party will not be treated as having an inventory method different from that used by another party to the section 381(a) transaction.

(3) *Elections and adoptions allowed.* If an election does not require the Commissioner's consent, an acquiring corporation or a distributor or transferor corporation is not precluded from making any election that is otherwise permissible for the taxable year that includes the date of distribution or transfer. For example, an acquiring corporation may elect to identify its inventory using the LIFO inventory method in the year of the distribution or transfer. For purposes of this section, a corporation shall be deemed as having made any election as of the first day of the taxable year that includes the date of distribution or transfer. Similarly, where adoption is permissible, an acquiring corporation or a distributor or transferor corporation may adopt any permissible method of accounting for the taxable year that includes the date of distribution or transfer.

(4) *Elections continue after section 381(a) transaction*—(i) *General rule.* An acquiring corporation is not required to renew any election not requiring renewal and previously made by it or by a distributor or transferor corporation for a carryover method or a principal method if the acquiring corporation uses the method after the section 381(a) transaction. If the acquiring corporation uses a method after the date of distribution or transfer, an election made by the acquiring corporation or by a distributor or transferor corporation for that method that was in effect on the date of distribution or transfer continues after the section 381(a) transaction as though the distribution or transfer had not occurred.

(ii) *Example.* The following example illustrates the rules of paragraph (e)(4):

Example. Since its incorporation in 1982, X Corporation elected to use the LIFO inventory method under section 472 to identify its inventory of tennis balls. Since its incorporation in 2002, T Corporation elected to use the FIFO inventory method to identify its inventory of tennis balls. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. Immediately prior to the date of distribution or transfer, the fair market value of X Corporation's inventory in its tennis balls exceeds the fair market value of the tennis balls inventory held by T Corporation. After the date of distribution or transfer, X Corporation will not operate its business as a trade or business that is separate and distinct from T Corporation's business. Because on the date of distribution or transfer T Corporation does not hold more inventory than X Corporation, the principal method for identifying inventory is the method used by X Corporation on the date of distribution or transfer. After the date of distribution or transfer, X Corporation need not renew its election to identify inventory using the LIFO inventory method, and X Corporation is bound by the election.

(5) *Adopting the LIFO inventory method.* A party to a section 381(a) transaction will be deemed to be using the LIFO inventory method for a particular type of goods on the date of distribution or transfer if that party elects under section 472 to adopt that inventory method with respect to those goods for its taxable year within which the date of distribution or transfer occurs. See section 472 for the requirements to adopt the LIFO inventory method.

(6) *Inventory layers treatment*—(i) *Adjustments required after a section 381(a) transaction.* An acquiring corporation that determines the principal method of taking an inventory after a section 381(a) transaction under paragraphs (a)(3) and (c) of this section after the date of distribution or transfer may need to integrate inventories and make appropriate adjustments as provided in paragraphs (e)(6)(ii) and (e)(6)(iii) of this section.

(ii) *LIFO inventory method used after the section 381(a) transaction*—(A) *LIFO inventory method used by the acquiring corporation and the distributor or transferor corporation*—(*1*) *Principal method is the dollar-value LIFO method.* If, under paragraphs (a)(3) and (c) of this section, the acquiring corporation changes its inventory method or the inventory method of the distributor or transferor corporation from the specific goods LIFO method of pricing inventories to the dollar-value LIFO method of pricing inventories (dollar-value LIFO method) for a particular type of goods, the inventory accounted for under the specific goods method shall be placed on the dollar-value method as provided in § 1.472–8(f), and then the inventory shall be integrated with the inventory previously accounted for under the dollar-value LIFO method. If pools of each corporation are permitted or required to be combined, the pools must be combined as provided in § 1.472–8(g)(2). For purposes of combining pools, all base year inventories or layers of increment that occur in taxable years including the same December 31 shall be combined. A base year inventory or layer of increment occurring in any short taxable year of a distributor or transferor corporation shall be merged with and considered a layer of increment of its immediately preceding taxable year.

(*2*) *Principal method is the specific goods LIFO method.* If, under paragraphs (a)(3) and (c) of this section, the acquiring corporation changes its inventory method or the inventory method of the distributor or transferor corporation from the dollar-value LIFO method of pricing inventories to the specific goods LIFO method of pricing inventories, the acquiring corporation shall treat the inventory being changed to the specific goods LIFO method as having the same acquisition dates and costs as such inventory had under the dollar-value LIFO method.

(B) *Change from the FIFO inventory method to either the specific goods LIFO method or the dollar-value LIFO method.* If, under paragraphs (a)(3) and (c) of this section, the acquiring corporation changes its inventory method or the inventory method of the distributor or transferor corporation from the FIFO inventory method to either the specific goods LIFO method or the dollar-value method of pricing LIFO inventories, the inventory accounted for under the FIFO inventory method shall be treated by the acquiring corporation as having been acquired at their average unit cost in a single transaction on the date of the distribution or transfer. Thus, if an inventory of a particular type of goods is combined in an existing dollar-value pool, the goods shall be treated as if they were purchased by the acquiring corporation at the average unit cost on the date of the distribution or transfer with respect to such pool. Alternatively, if the goods are not combined in an existing pool, the goods will be treated as if they were purchased by the acquiring corporation at the average unit cost on the date of the distribution or transfer with respect to a new pool, with the base-year being the year of the section 381(a) transaction. Adjustments resulting from a restoration to cost of any write-down to market value of the inventories shall be taken into account by the acquiring corporation ratably in each of the three taxable years beginning with the taxable year that includes the date of the distribution or transfer. See section 472(d).

(iii) *FIFO inventory method used after the section 381(a) transaction*—(A) *FIFO inventory method used by the acquiring corporation and the distributor or transferor corporation.* If, under paragraphs (a)(3) and (c) of this section, the FIFO inventory method is the principal method and the component trades or businesses of both the acquiring corporation and the distributor or transferor corporation use the FIFO method immediately prior to the distribution or transfer, the acquiring corporation must treat the inventory that must change to the principal method as having the same acquisition dates and costs as such inventory had immediately prior to the date of distribution or transfer. However, if the principal method of valuing inventories is the cost or market, whichever is lower, method, the acquiring corporation must treat the inventories that must change to the principal method as having been acquired at cost or market, whichever is lower.

(B) *Change from either the specific goods LIFO method or the dollar-value LIFO method to the FIFO inventory method.* If, under paragraphs (a)(3) and (c) of this section, the acquiring corporation changes its inventory method or the inventory method of the distributor or transferor corporation from either the specific goods LIFO method or the dollar-value LIFO method to the FIFO inventory method, the acquiring corporation must treat the inventory accounted for under the LIFO method as having the same acquisition dates and costs that the inventory would have had if the FIFO inventory method had been used on the date of distribution or transfer. However, if the principal method of valuing inventories is the cost or market, whichever is lower, method, the acquiring corporation must treat the inventories accounted for under the LIFO method as having been acquired at cost or market, whichever is lower.

(7) *Appropriate times for certain determinations*—(i) *Determining the inventory method.* The inventory method used by a party to a section 381(a) transaction on the date of distribution or transfer is the method used by that party as of the end of the day that is immediately prior to the date of distribution or transfer.

(ii) *Determining whether there are separate and distinct trades or businesses after the date of distribution or transfer.* Whether an acquiring corporation will operate the trades or businesses of the parties to a section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer will be determined as of the date of distribution or transfer based upon the facts and circumstances. Intent to combine books and records of the trades or businesses may be demonstrated by contemporaneous records and documents or by other objective evidence that reflects the acquiring corporation's ultimate plan of operation, even though the actual combination of the books and records may extend beyond the end of the taxable year that includes the date of distribution or transfer.

(8) *Establishing an inventory method.* An inventory method used by the distributor or transferor corporation immediately prior to the date of distribution or transfer that continues to be used by the acquiring corporation after the date of distribution or transfer is an established method of accounting for purposes of section 446(e), whether or not such method is proper or is permitted under the Internal Revenue Code or any applicable Income Tax Regulations.

(9) *Other applicable provisions.* This section does not preempt any other provision of the Internal Revenue Code or the Income Tax Regulations that is applicable to the acquiring corporation's circumstances. Section 381(c)(5) and this § 1.381(c)(5)–1 determine only the inventory method to be used after a section 381(a) transaction. If other paragraphs of section 381(c) apply for purposes of determining the methods of accounting to be used following the date of distribution or transfer, section 381(c)(5) and this § 1.381(c)(5)–1 will not apply to the tax treatment of the items. Specifically, section 381(c)(5) and this § 1.381(c)(5)–1 do not apply to assets other than inventory that an acquiring corporation obtains in a transaction to which section 381(a) applies.

(10) *Use of the cash receipts and disbursements method of accounting.* If immediately prior to the date of distribution or transfer, an acquiring corporation or a distributor or transferor corporation uses the cash receipts and disbursements method of accounting within the meaning of section 446(c)(1) and § 1.446–1(c)(1)(i), or is not required to use an inventory method for its goods, section 381(c)(5) and § 1.381(c)(5)–1 do not apply. Instead, section 381(c)(4) and § 1.381(c)(4)–1 must be applied to determine the methods of accounting that continue after the transaction.

(11) *Character of items of income and deduction.* After the date of distribution or transfer, items of income and deduction have the same character in the hands of the acquiring corporation as they would have had in the hands of the distributor or transferor corporation if no distribution or transfer had occurred.

(12) *Impermissible inventory method.* This section does not limit the Commissioner's ability under section 446(b) to determine whether a taxpayer's inventory method is an impermissible method or otherwise fails to clearly reflect income. For example, an acquiring corporation may not use the method of accounting determined under paragraph (a)(2) of this section if the method fails to clearly reflect the acquiring corporation's income within the meaning of section 446(b).

(f) *Effective/applicability date.* This section applies to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

■ **Par. 5.** Section 1.446–1 is amended by:

■ 1. Revising the first sentence and adding a second new sentence in paragraph (e)(3)(i).

■ 2. Revising the first sentence in paragraph (e)(4)(i).

■ 3. Adding paragraph (e)(4)(iii).

The revisions and addition read as follows:

§ 1.446–1 General rule for methods of accounting.

* * * * *

(e) * * *

(3)(i) Except as otherwise provided under the authority of paragraph (e)(3)(ii) of this section, to secure the Commissioner's consent to a taxpayer's change in method of accounting the taxpayer generally must file an application on Form 3115, ''Application for Change in Accounting Method,'' with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting. See §§ 1.381(c)(4)–1(d)(2) and 1.381(c)(5)–1(d)(2) for rules allowing additional time, in some circumstances, for the filing of an application on Form 3115 with respect to a transaction to which section 381(a) applies. * * *

* * * * *

(4) * * * (i) * * * Except as provided in paragraphs (e)(3)(iii), (e)(4)(ii), and (e)(4)(iii) of this section, paragraph (e) of this section applies on or after December 30, 2003. * * *

* * * * *

(iii) *Effective/applicability date for paragraph (e)(3)(i).* The rules of paragraph (e)(3)(i) of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

Approved: July 20, 2011.

Steven T. Miller,

Deputy Commissioner for Services and Enforcement.

Emily S. McMahon,

Acting Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY

Financial Crimes Enforcement Network

31 CFR Part 1010

RIN 1506–AA82

Financial Crimes Enforcement Network; Repeal of the Final Rule and Withdrawal of the Finding of Primary Money Laundering Concern Against VEF Banka

AGENCY: Financial Crimes Enforcement Network (''FinCEN''), Treasury.

ACTION: Final rule.

SUMMARY: This document repeals FinCEN's final rule, ''Imposition of Special Measure Against VEF Banka'' of July 13, 2006, and withdraws the finding of VEF Banka as a Financial Institution of Primary Money Laundering Concern of April 26, 2005, issued pursuant to 31 U.S.C. 5318A of the Bank Secrecy Act (the ''BSA'').

DATES: *Effective Date:* August 1, 2011.

FOR FURTHER INFORMATION CONTACT: Regulatory Policy and Programs Division, Financial Crimes Enforcement Network, (800) 949–2732 and select Option 1.

SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory Provisions

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Public Law 107–56 (''USA PATRIOT Act''). Title III of the USA PATRIOT Act amends the anti-money laundering provisions of the BSA, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951–1959, and 31 U.S.C. 5311–5314 and 5316–5332, to promote the prevention, detection, and prosecution of money laundering and the financing of terrorism. Regulations implementing the BSA appear at 31 CFR Chapter X.[1] The authority of the Secretary of the Treasury (the ''Secretary'') to administer the BSA and its implementing regulations has been delegated to the Director of the Financial Crimes Enforcement Network.[2]

Section 311 of the USA PATRIOT Act (''section 311'') added Section 5318A to the BSA, granting the Secretary the authority, upon finding that reasonable grounds exist for concluding that a foreign jurisdiction, foreign financial institution, class of international transactions, or type of account is of ''primary money laundering concern,'' to require domestic financial institutions and domestic financial agencies to take certain ''special measures'' against the primary money laundering concern.[3]

Taken as a whole, Section 5318A provides the Secretary with a range of options that can be adapted to target specific money laundering and terrorist financing concerns most effectively. These options provide the authority to bring additional and useful pressure on those jurisdictions and institutions that pose money-laundering threats and the ability to take steps to protect the U.S. financial system. Through the imposition of various special measures, FinCEN can: gain more information about the concerned jurisdictions, financial institutions, transactions, and accounts; monitor more effectively the respective jurisdictions, financial institutions, transactions, and accounts; and, ultimately, protect U.S. financial institutions from involvement with jurisdictions, financial institutions, transactions, or accounts that pose a money laundering concern.

B. VEF Banka

At the time of issuance of the final rule on July 13, 2006, VEF Banka was headquartered in Riga, Latvia. VEF Banka was one of the smallest of Latvia's 23 banks, and, in 2004, was reported to have approximately $80 million in assets and 87 employees. Total assets for the bank, as of June 30, 2005, were 27.3 million LATS, equivalent to approximately $47.4 million. VEF Banka had one subsidiary, Veiksmes līzings, which offered financial leasing and factoring services. In addition to its headquarters in Riga, VEF Banka had one branch in Riga and one representative office in the Czech Republic. VEF Banka offered corporate and private banking services, issued credit cards for non-Latvians, and provided currency exchange through Internet banking services (i.e., virtual currencies). In addition, according to its financial statements, VEF Banka maintained correspondent accounts in countries worldwide, but reported none in the United States at the time of the final rule.

II. The Finding, Final Rule, and Subsequent Developments

A. The Finding and Final Rule

Based upon review and analysis of relevant information, consultations with relevant Federal agencies and departments, and after consideration of the factors enumerated in section 311, the Secretary, through his delegate, the Director of FinCEN, found that reasonable grounds existed for concluding that VEF Banka was a financial institution of primary money laundering concern. This finding was published on April 26, 2005,[4] in a notice of proposed rulemaking which proposed prohibiting covered financial institutions from, directly or indirectly, opening or maintaining correspondent accounts in the United States for VEF Banka or any of its branches, offices, or subsidiaries, pursuant to the authority under 31 U.S.C. 5318A. The notice of proposed rulemaking outlined the various factors supporting the finding and proposed prohibition.

After consulting with required Federal agencies and parties, reviewing public comments received from the April 26, 2005 notice of proposed rulemaking, and considering additional relevant factors, FinCEN issued a final rule on July 13, 2006 that imposed the special measure authorized under 31 U.S.C. 5318A(b)(5) against VEF Banka.[5] This final rule requires covered financial institutions to terminate any correspondent or payable-through

[1] On October 26, 2010, FinCEN issued a final rule creating a new Chapter X in Title 31 of the Code of Federal Regulations for the BSA regulations. See 75 FR 65806 (October 26, 2010) (Transfer and Reorganization of Bank Secrecy Act Regulations Final Rule) (referred to herein as the ''Chapter X Final Rule''). The Chapter X Final Rule became effective on March 1, 2011.

[2] Therefore, references to the authority of the Secretary under section 311 of the USA PATRIOT Act apply equally to the Director of the Financial Crimes Enforcement Network.

[3] Available special measures include requiring: (1) Recordkeeping and reporting of certain financial transactions; (2) collection of information relating to beneficial ownership; (3) collection of information relating to certain payable-through accounts; (4) collection of information relating to certain correspondent accounts; and (5) prohibition or conditions on the opening or maintaining of correspondent or payable-through accounts. 31 U.S.C. 5318A(b)(1)–(5). For a complete discussion of the range of possible countermeasures, see 68 FR 18917 (April 17, 2003) (proposing to impose special measures against Nauru).

[4] *See* 70 FR 21369 (April 26, 2005, RIN 1506–AA82).

[5] *See* 71 FR 39554 (July 13, 2006, RIN 1506–AA82).