**PART 416—SUPPLEMENTAL SECURITY INCOME FOR THE AGED, BLIND, AND DISABLED**

**Subpart I—[Amended]**

3. The authority citation for subpart I of part 416 continues to read as follows:

**Authority:** Secs. 221(m), 702(a)(5), 1611, 1614, 1619, 1631(a), (c), (d)(1), and (p), and 1633 of the Social Security Act (42 U.S.C. 421(m), 902(a)(5), 1382, 1382c, 1382h, 1383(a), (c), (d)(1), and (p), and 1383b); secs. 4(c) and 5, 6(c)–(e), 14(a), and 15, Pub. L. 98–460, 98 Stat. 1794, 1801, 1802, and 1808 (42 U.S.C. 421 note, 423 note, 1382h note).

4. Revise paragraph (e)(1) of § 416.919s to read as follows:

**§ 416.919s Authorizing and monitoring the consultative examination.**

* * * * *

(e) * * *

(1) Any consultative examination provider with an estimated annual billing to the disability programs we administer of at least $150,000; or

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[FR Doc. E7–4958 Filed 3–19–07; 8:45 am]

**BILLING CODE 4191–02–P**

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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

**[REG–113365–04]**

**RIN 1545–BD19**

## Escrow Accounts, Trusts, and Other Funds Used During Deferred Exchanges of Like-Kind Property

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

**ACTION:** Proposed Rulemaking; Revised Initial Regulatory Flexibility Analysis.

**SUMMARY:** This document contains a revised initial regulatory flexibility analysis relating to proposed regulations under section 468B of the Internal Revenue Code on the taxation and reporting of income earned on escrow accounts, trusts, and other funds used during deferred exchanges of like-kind property, and proposed regulations under section 7872 regarding below-market loans to facilitators of these exchanges. The proposed regulations affect taxpayers that engage in deferred like-kind exchanges and escrow holders, trustees, qualified intermediaries, and others that hold funds during deferred like-kind exchanges.

**DATES:** Written or electronic comments must be received by May 4, 2007.

**ADDRESSES:** Send submissions to CC:PA:LPD:PR (REG–113365–04), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–113365–04), courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit electronic comments via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS–REG–113365–04).

**FOR FURTHER INFORMATION CONTACT:** Concerning the revised initial regulatory flexibility analysis and the proposed regulations under section 468B, Jeffrey Rodrick, (202) 622–4930; concerning the proposed regulations under section 7872, David Silber, (202) 622–3930; concerning submission of comments, Kelly Banks, (202) 622–3628 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:** On February 7, 2006, a partial withdrawal of notice of proposed rulemaking, notice of proposed rulemaking, and notice of public hearing was published in the **Federal Register** (71 FR 6231). The initial regulatory flexibility analysis included in that notice of proposed rulemaking concluded that the number of transactions involving small businesses that will be affected and the full extent of the economic impact on small businesses could not be precisely determined and requested additional comments. This notice revises the initial regulatory flexibility analysis included in that notice of proposed rulemaking in response to comments provided in writing and at a public hearing. These comments asserted that the analysis did not adequately define the industry, determine the number of small businesses affected, describe the economic impact of the proposed regulations on small businesses, or discuss alternatives to the proposed rules that were considered and the bases for conclusions reached. The IRS and the Department of the Treasury have worked closely with the Small Business Administration's (SBA) Office of Advocacy (Advocacy) to obtain additional information from the affected industry to identify and quantify the small businesses affected and to determine the likely economic impact of the proposed regulations on small businesses. In a letter dated August 3, 2006, the president of the leading industry association for qualified intermediaries (QI), wrote that the association "believes we have or can develop information that would be helpful in this [impact-study] effort," and volunteered to provide this information to the IRS. The industry association surveyed its members based on questions developed by the IRS and the Department of the Treasury, and submitted a summary of the survey responses for consideration. The association, which according to its Web site has over 300 member companies (not all of which are QIs), received approximately 130 responses. Seventy-one respondents indicated they engage in the QI business exclusively, which represents 22 percent of the estimated number of 325 full-time QIs in the industry (as discussed in this notice, not all of which are small businesses). The summary of the survey responses submitted did not address a substantial number of the issues important to evaluating the effect of the proposed regulations on small business. The summary of the survey responses is available at *http://www.IRS.gov/regs.* This notice seeks additional comments and reiterates questions that will assist in assessing the economic impact of the proposed regulations on small businesses in the QI industry and in considering reasonable alternatives. The survey information provided is discussed in this revised initial regulatory flexibility analysis and will be considered further in the development of final regulations.

### Revised Initial Regulatory Flexibility Analysis

*Reasons for Action and Succinct Statement of the Objectives of, and Legal Basis for, the Proposed Rule*

The proposed regulations are issued under the authority of section 7805, section 468B(g) (which provides that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax and that the Secretary shall prescribe regulations providing for the taxation of such accounts or funds whether as a grantor trust or otherwise), and section 7872.

Section 1.468B–6 of the Income Tax Regulations was included in proposed regulations issued in 1999 under section 468B(g) (the 1999 proposed regulations), and provided rules for the current taxation of income of a qualified escrow account or qualified trust used in a section 1031 deferred exchange of like-kind property. The 1999 proposed regulations included a facts and circumstances test to determine whether the taxpayer (the transferor or exchangor of the property), the QI, or a transferee is the owner of the assets in a qualified escrow account or qualified trust and must take into account all items of income, deduction, and credit (including capital gains and losses) of the account or trust. The 1999 proposed regulations further provided that, if a QI or transferee is the owner of the assets transferred, the transaction may be characterized as a below-market loan from the taxpayer to the owner to which section 7872 may apply. Under this proposed rule, if a QI or transferee is the owner of the assets, the transaction is a loan to which section 7872 generally applies if the loan is below-market.

Comments received on the 1999 proposed regulations reflected differing interpretations of the 1999 proposed regulations and disagreement on the proper rules for taxing these transactions. Some commentators interpreted the 1999 proposed regulations as allowing a QI to ''own'' the funds held in connection with the deferred like-kind exchange and never characterize the arrangement between the taxpayer and the QI as a loan.

Rules based on a facts-and-circumstances test are inherently difficult for taxpayers to apply and for the IRS to administer, and are subject to inconsistent application. Therefore, the 2006 proposed regulations eliminate the facts and circumstances test and propose specific rules that determine whether the income of an escrow account, trust, or fund used in a deferred like-kind exchange is taxed to the taxpayer or to an exchange facilitator, which is a QI, transferee, or other party that holds the exchange funds. These rules are intended to provide greater certainty for taxpayers, enhance administrability, and ensure consistent treatment of taxpayers.

*Description and Estimate of the Number of Small Businesses to Which the Proposed Regulations Will Apply*

The 2006 proposed regulations affect exchange facilitators that hold exchange funds for taxpayers engaging in deferred exchanges of like-kind property. Exchange facilitators may be large or small businesses (including individuals operating as sole proprietors). For this purpose, the SBA size standards set forth at 13 CFR 121.201 for North American Industry Classification System (NAICS) code 531390 (other activities related to real estate), define a business with annual gross receipts of up to $2 million as a small business. There is no NAICS code associated specifically with exchange facilitators or QIs. Although like-kind exchanges are not limited to real estate transactions, 70 percent of the respondents to the industry survey indicated that they use NAICS code 531390. Therefore, notwithstanding comments criticizing the use of NAICS code 531390 for purposes of determining the applicable size standard with respect to the 2006 proposed regulations, after consultation with Advocacy, the IRS and the Department of the Treasury have determined that NAICS code 531390 is appropriate for this industry. Accordingly, the applicable size standard for determining what constitutes a small business with respect to the 2006 proposed regulations is $2 million in annual gross receipts, the SBA's definition of a small business for NAICS code 531390.

The IRS and the Department of the Treasury estimate that there are approximately 325 businesses (primarily QIs) that are full-time exchange facilitators. This estimate is based on information originally provided by the industry association in connection with the development of the 2006 proposed regulations. The recent industry survey did not provide any additional information regarding this number. Seventy-one of 121 (58.7 percent) respondents to the survey indicated that they are engaged exclusively in the QI business, although it is unclear how many of these are small businesses. Although 84 percent of respondents reported having annual gross revenues (fees plus net retained interest, if any) from the QI business of $1.5 million or less (the previous size standard for NAICS code 531390) for the most recent year, it is unclear how many of this number are exclusively in the QI business. The survey also indicated that almost 90 percent of respondents have 10 or fewer employees (including owners active in the business), and nearly 70 percent have fewer than 5 employees. An estimate of the percentage of the QI industry that consists of small businesses is difficult to make based on the available information. The summary of the survey responses did not correlate information on annual gross revenues reported with information on the number of respondents engaged exclusively in the QI business. Nonetheless, it appears that a significant portion of the QI industry consists of small businesses under the SBA's size standard. Accordingly, the IRS and the Department of the Treasury continue to seek information regarding the number of small businesses engaged in the QI industry. Specific comments are requested from QIs engaged exclusively in that business indicating whether their annual gross receipts are $2 million or less, or more than $2 million.

Searches for information through the Department of Commerce and the SBA disclosed no data collected or maintained on QIs or exchange facilitators as an industry.

*Description of Compliance Requirements and Estimate of the Classes of Small Businesses That Will Be Affected by the Compliance Requirements*

Under the 2006 proposed regulations, exchange funds are treated as loaned by the taxpayer to the exchange facilitator unless all of the income earned is paid to the taxpayer. If the exchange funds are treated as loaned to the exchange facilitator, interest generally is imputed to the taxpayer under section 7872 unless the exchange facilitator pays sufficient interest. If a loan between the taxpayer and the exchange facilitator does not provide for sufficient interest and the loan is not otherwise exempt from section 7872, interest income is imputed to the taxpayer at the applicable Federal rate (AFR) (or the difference between the rate paid and the AFR). Therefore, exchange facilitators must keep records of the amount of income paid to the taxpayer and may be required to report the income on Form 1099.

Under section 7872 and the 2006 proposed regulations, if the exchange funds are treated as loaned from the taxpayer to the QI and the loan is a below-market loan, income is deemed transferred to the exchange facilitator as compensation and retransferred to the taxpayer as interest. The taxpayer's imputed interest income is not offset by a deduction for the taxpayer's imputed payment to the exchange facilitator because compensation paid to the exchange facilitator is a cost of acquiring the replacement property that must be capitalized and added to the property's basis. The exchange facilitator has income from the imputed compensation and an offsetting deduction for the interest deemed paid to the taxpayer.

Seventy percent of respondents to the industry survey reported that they engage in at least 100 exchange transactions a year. According to information provided by the industry association from an earlier survey of its members, over 92 percent of the small business respondents currently pay to the taxpayer at least 20 percent of the income earned on exchange funds, including accounts that commingle the exchange funds of multiple taxpayers. The IRS and the Department of the Treasury request additional comments providing more specific information to clarify these results. The information available suggests that an overwhelming majority of small businesses affected by the 2006 proposed regulations currently maintain records of the amount of income paid to the taxpayer and report the payments on Form 1099. Therefore, the IRS and the Department of the Treasury estimate that for most small businesses the 2006 proposed regulations should not increase significantly the compliance burden associated with keeping records and reporting income paid to the taxpayer.

Nonetheless, commentators have stated generally that complying with the 2006 proposed regulations would result in additional recordkeeping and reporting requirements. Fifty-eight percent of respondents to the recent industry survey indicated that the 2006 proposed regulations significantly will increase recordkeeping burdens and accounting costs, but the survey did not provide quantified data on the amount of any additional time or cost expected to result from the 2006 proposed regulations. Comments are requested estimating the annual number of transactions that will result in an increased recordkeeping and reporting burden, per transaction, under the 2006 proposed regulations, as well as the amount of time and additional cost that each additional recordkeeping and reporting burden would impose.

Commentators also have stated that accounting for individual taxpayers' earnings in commingled accounts would necessitate additional labor and system design costs that would fall disproportionately on small business QIs. The IRS and the Department of the Treasury have not received specific comments quantifying the effect of these costs on small businesses. Specific comments are requested estimating the amount of these costs.

Commentators have asserted that complying with the loan characterization rules of the 2006 proposed regulations will result in a substantial revenue loss and cause a large number of small businesses to fail or to reduce their workforces. They claimed that small business QIs would be disproportionately affected because the small business QIs predominantly apply a business model that would place them at a disadvantage under the 2006 proposed regulations.

In general, commentators have described two business models employed to facilitate deferred like-kind exchanges:

1. The exchange facilitator segregates the exchange funds in separate accounts, charges a separate fee for its services, and pays all earnings to the taxpayer, or

2. The exchange facilitator commingles the exchange funds, pays a portion of the earnings to the taxpayer and retains a portion of the earnings, or may retain all of the earnings. Some of these exchange facilitators also may charge a separate fee for their services. If a fee is charged, it is likely to be lower than the fee that would be charged if the exchange facilitator retains no earnings.

Some small businesses offer customers both forms of structuring the transaction. Comments from and discussions with industry members, however, have disclosed that the first model is employed most commonly by large businesses often ''affiliated'' (in the sense of having some level of corporate relationship and not necessarily within the meaning of section 1504) with banks. The second model also may be employed by large businesses but is used widely by independent, small business QIs. In the recent industry survey, 95.8 percent of respondents indicated that they are not affiliated with a bank, savings and loan company, brokerage firm, or similar financial institution.

The earlier industry survey indicated that 96 percent of the small business respondents retain at least a portion of the interest earned on the exchange funds. Commentators have stated that if these small businesses are required to impute interest on the exchange funds, taxpayers will demand that this interest be paid to them. According to commentators, to compensate for this loss of revenue these businesses will be required to change their business practices to pay all income to the taxpayer and to charge higher fees. Commentators further stated that absent charging higher fees, paying all interest to the taxpayer is expected to result in a reduction of revenues ranging from 10 to 80 percent. Specific comments are requested estimating the effect on revenues or profits of a change in business practices to pay all income to the taxpayer.

Some commentators have asserted that, in contrast, bank-affiliated QIs generally pay all the income to the taxpayer under their current business practices and therefore will not be required to change their business practices or charge higher fees as a result of the 2006 proposed regulations. These commentators claim that bank-affiliated QIs are able to pay all the income to the taxpayer and charge fees commensurate with the fees charged by independent QIs because bank-affiliated QIs are compensated through the receipt of fees paid by institutions in which the funds are deposited. Moreover, these commentators maintain that bank-affiliated QIs indirectly benefit when funds are deposited with related-party depositary institutions that invest deposited exchange funds and earn income that is not required to be paid to the taxpayer under the 2006 proposed regulations. If, as these commentators claim, bank-affiliated QIs would not be required to change their business model as a result of the 2006 proposed regulations, the commentators predict that the 2006 proposed regulations will cause many small business QIs to be disadvantaged in competing with bank-affiliated QIs. Specific comments are requested estimating the number of QIs that would change their business model as a result of the 2006 proposed regulations.

*Significant Alternatives Considered*

Various alternatives to the rules contained in the 2006 proposed regulations were considered. For example, retaining the facts and circumstances test of the 1999 proposed regulations was considered but rejected because the test is difficult for taxpayers to apply, lacks administrability, is subject to misinterpretation, and may result in inconsistent tax treatment of similarly-situated taxpayers.

Rules that would allow the exchange facilitator and taxpayer to determine which party will be taxed on the earnings were considered but regarded as lacking certainty and administrability and violating established tax principles. Rules that would tax the party that receives the income (and thus treat only income paid and not income retained by the QI as the taxpayer's taxable income) were considered but not adopted. Under some circumstances, a QI's retention of income earned by an exchange fund is properly characterized as a payment of compensation by the taxpayer for the QI's services. Therefore, under the appropriate circumstances, a rule that taxed only the QI on retained earnings would violate the doctrine of *Old Colony Trust* v. *Commissioner*, 279 U.S. 716 (1929), that a payment that satisfies the obligation of a taxpayer to a third party is includible in the income of the taxpayer.

A rule that would treat all the earnings of the exchange funds in all circumstances as the taxpayer's income was considered but lacked flexibility and did not conform in all cases to the substance of the transaction. Other alternatives were considered and not adopted because they were considered inconsistent with section 7872. In the legislative history to section 7872, Congress stated that when a service provider is permitted to retain customer funds without paying interest to the customer, and the benefit the service provider derives from the funds is in lieu of a fee for services, the transaction is a compensation-related loan under section 7872. H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1019 (1984) (1984–3 (Vol. 2) CB 272). Moreover, it was determined that exchange funds are not received in consideration for the sale or exchange of property (within the meaning of section 1274(c)(1)) or received as a deferred payment on account of a sale or exchange of property (within the meaning of section 483).

The industry survey indicates that 30 percent of respondents closed at least half of their deferred like-kind exchange transactions within 60 days or less. Only eight percent completed at least half of their transactions in more than 150 days. In addition, 42 percent of survey respondents reported that at least half of their transactions typically involve exchange funds of $250,000 or less, while about 8 percent of respondents reported that most of their transactions involve exchange funds in excess of $1 million. In light of this information, comments specifically are requested regarding the average duration of exchange transactions, the average dollar amount of exchange funds, and the appropriateness and nature of a de minimis rule that would except certain exchange transactions from the application of section 7872.

If exchange funds are characterized as loaned by the taxpayer to the exchange facilitator, interest may be imputed if the exchange facilitator does not pay sufficient interest to the taxpayer. To reduce the administrative burden of determining imputed interest, the 2006 proposed regulations provide a special AFR, equal to the investment rate on a 182-day Treasury bill, in lieu of the short-term AFR (which applies to loans of 3 years or less), to qualify as sufficient interest for purposes of determining whether interest must be imputed. This special AFR was intended to be a more accurate measure of a market rate of interest for these loans than the short-term AFR, and was expected to result in characterization of fewer transactions as below-market loans than if the short-term AFR were used. Commentators have stated that the special AFR is significantly higher than the market rate paid on funds held for the periods of time that exchange funds typically are held by QIs. They state, for example, that few if any QIs that pay less than all the income to the taxpayer pay an amount that is equal to or greater than the special AFR provided in the 2006 proposed regulations. Specific comments are requested identifying the rate of return typically earned by small business QIs on exchange funds, the interest rate QIs typically pay to taxpayers, and an appropriate rate for testing exchange facilitator loans for sufficient interest under section 7872.

*Duplicative, Overlapping, and Conflicting Rules*

The IRS and the Department of the Treasury are not aware of any duplicative, overlapping, or conflicting Federal rules.

**Kevin M. Brown,**

*Deputy Commissioner for Services and Enforcement.*

[FR Doc. E7–4968 Filed 3–19–07; 8:45 am]

BILLING CODE 4830–01–P

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## DEPARTMENT OF THE TREASURY

## Internal Revenue Service

## 26 CFR Part 1

**[REG–146247–06]**

**RIN 1545–BG15**

## Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest

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

**ACTION:** Notice of proposed rulemaking by cross-reference to temporary regulations.

**SUMMARY:** In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations that provide guidance regarding the satisfaction of the continuity of interest requirement for corporate reorganizations. The text of those regulations also serves as the text of these proposed regulations.

**DATES:** Written or electronic comments and requests for a public hearing must be received by June 18, 2007.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG–146247–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA: LPD:PR (REG–146247–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov/* (IRS and REG–146247–06).

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Lisa S. Dobson at (202) 622–7790; concerning submissions of comments and requests for a public hearing, Kelly Banks at (202) 622–0392 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

### Background and Explanation of Provisions

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) relating to section 368, which provides for general nonrecognition treatment for reorganizations. In addition to complying with the statutory and certain other requirements, to qualify as a reorganization, a transaction generally must satisfy the continuity of interest (COI) requirement. COI requires that, in substance, a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Requests for Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.