have a value of $75, T distributes all of its assets to P in a complete liquidation to which section 332 applies.

(ii) *Analysis*. Under paragraphs (b)(1) and (f)(2) of this section, S's distribution of the T stock to P is an intercompany transaction, S is the selling member, and P is the buying member. In Year 9 when T liquidates, P has $0 of unrecognized gain or loss under section 332 because P has a $75 basis in the stock of T and receives a $75 distribution with respect to its T stock. Under paragraph (b)(3)(ii) of this section, P's $0 of unrecognized gain or loss with respect to the T stock under section 332 is a corresponding item. P takes $45 of its intercompany gain into account under the matching rule in Year 9 to reflect the difference between P's $0 of unrecognized gain and P's $45 of recomputed unrecognized gain. (If P and S were divisions of a single corporation, P would have had a $40 basis in the T stock, and, after the Year 7 distribution of the T1 stock, would have held the T stock with a $30 basis.) Paragraph (c)(6) of this section does not prevent the redetermination of P's intercompany gain as excluded from gross income to the extent that the gain is P's intercompany item, P holds the T stock with respect to which this portion of the intercompany gain was realized, P's basis in the T stock that reflects the $45 intercompany gain taken into account is eliminated without the recognition of gain or loss (and this eliminated basis is not further reflected in the basis of any successor asset), the group has not derived any Federal income tax benefit from the basis in the T stock and will not derive any Federal income tax benefit from a redetermination of this portion of the gain, and the effects of the intercompany transaction have not previously been reflected, directly or indirectly, on the P group's consolidated return. (See paragraph (c)(6)(ii)(C) of this section). Accordingly, under paragraph (c)(6)(ii)(C) of this section, the $45 intercompany gain that P takes into account is redetermined to be excluded from gross income.

Example 8. Intercompany stock sale followed by section 355 distribution by the common parent. (i) *Facts*. The facts are the same as *Example 7*, except that T does not distribute the stock of T1, instead, in Year 7, T makes a distribution of $50 to P in a transaction to which section 301 applies. Under § 1.1502–32, P's basis in its T stock is reduced by $50 and, under paragraph (f)(2)(ii) of this section, the intercompany distribution is excluded from P's gross income. Further, in Year 9, instead of liquidating T, P distributes the T stock to its shareholders in a transaction to which section 355 applies.

(ii) *Analysis*. On the distribution of the T stock, P has $0 of unrecognized gain under section 355(c) because P has a $50 basis in the stock of T which has a value of $50. Under paragraph (b)(3)(ii) of this section, P's $0 of unrecognized gain or loss with respect to the T stock under section 355(c) is a corresponding item. P takes its $60 intercompany gain into account under the matching rule in Year 9 to reflect the difference between P's $0 of unrecognized gain and P's $60 of recomputed gain ($50 unrecognized gain and $10 recognized gain). (If P and S were divisions of a single corporation, P would have had a $40 basis in the T stock, and, after the Year 7 distribution, would have held the T stock with a $10 excess loss account.) Paragraph (c)(6) of this section does not prevent the redetermination of P's intercompany gain as excluded from gross income to the extent that the gain is P's intercompany gain, P holds the T stock with respect to which this portion of the intercompany gain was realized, P's basis in the T stock that reflects the $60 intercompany gain taken into account is eliminated without the recognition of gain or loss (and this eliminated basis is not further reflected in any successor asset), the group has not derived any Federal income tax benefit from the basis in the T stock and will not derive any Federal income tax benefit from a redetermination of this portion of the gain, and the effects of the intercompany transaction have not previously been reflected, directly or indirectly, on the P group's consolidated return. (See paragraph (c)(6)(ii)(C) of this section). The intercompany transaction with respect to the T stock resulted in an increase in the basis of the T stock, and this increase in the basis of the T stock prevented P from holding the T stock with a $10 excess loss account (as a result of the Year 7 distribution) at the time of the section 355 distribution. Accordingly, the group derived a Federal income tax benefit from the intercompany transaction to the extent of $10. As such, under paragraph (c)(6)(ii)(C) of this section, only $50 of the $60 intercompany gain that P takes into account is redetermined to be excluded from gross income.

(iii) *Application of section 355(e)*. If it was determined that section 355(e) applied to P's distribution of the T stock, P would recognize $0 of gain and derive a Federal income tax benefit to the extent of the full $60 increase in the basis of the T stock. Therefore, no portion of P's intercompany gain would be redetermined to be excluded from gross income under paragraph (c)(6)(ii)(C) of this section.

(ii) *Effective/applicability date*—(A) *In general*. Paragraph (f)(7)(i) *Examples 7* and *8* of this section apply with respect to items taken into account on or after *March 7, 2008*.

(B) *Expiration date*. The applicability of paragraph (f)(7)(i) *Examples 7* and *8* of this section will expire on *March 7, 2011*.

(g) through (m) [Reserved]. For further guidance, see § 1.1502–13(g) through (m).

Approved: March 3, 2008.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. E8–4573 Filed 3–6–08; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9384]

RIN 1545–BG33

Qualified Films Under Section 199

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations involving the deduction for income attributable to domestic production activities under section 199. The final regulations revise certain rules and examples relating to the definitions of a qualified film produced by the taxpayer under section 199(c)(4)(A)(i)(II) and (c)(6) and an expanded affiliated group under section 199(d)(4). The final regulations affect taxpayers who produce qualified films and taxpayers who are members of expanded affiliated groups.

DATES: *Effective Date:* These regulations are effective March 7, 2008.

Applicability Date: For dates of applicability, see § 1.199–8(i)(8) and (9).

FOR FURTHER INFORMATION CONTACT: Concerning § 1.199–3(k), David McDonnell, at (202) 622–3040; concerning § 1.199–7, Ken Cohen (202) 622–7790 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document amends §§ 1.199–3(k) and 1.199–7 of the Income Tax Regulations (26 CFR Part 1). Section 1.199–3(k) relates to the definition of qualified film produced by the taxpayer under section 199(c)(4)(A)(i)(II) and (c)(6) of the Internal Revenue Code (Code) and § 1.199–7 involves expanded affiliated groups under section 199(d)(4). Section 199 was added to the Code by section 102 of the American Jobs Creation Act of 2004 (Pub. L. 108–357, 118 Stat. 1418), and amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109–135, 119 Stat. 25), section 514 of the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. 109–222, 120 Stat. 345), and section 401 of the Tax Relief and Health Care Act of 2006 (Pub. L. 109–432, 120 Stat. 2922).

On June 7, 2007, the IRS and Treasury Department published proposed regulations under section 199 (72 FR 31478). The proposed regulations revise certain rules and examples in TD 9263 (71 FR 31268) relating to qualified films produced by the taxpayer under section

199(c)(4)(A)(i)(II) and (c)(6) and expanded affiliated groups under section 199(d)(4). No comments were received responding to the notice of proposed rulemaking and no public hearing was requested or held. Therefore, the proposed regulations are adopted without change by this Treasury decision.

Explanation of Provisions

General Overview

Section 199(a)(1) allows a deduction equal to 9 percent (3 percent in the case of taxable years beginning in 2005 or 2006, and 6 percent in the case of taxable years beginning in 2007, 2008, or 2009) of the lesser of (A) the qualified production activities income (QPAI) of the taxpayer for the taxable year, or (B) taxable income (determined without regard to section 199) for the taxable year (or, in the case of an individual, adjusted gross income).

Section 199(c)(1) defines QPAI for any taxable year as an amount equal to the excess (if any) of (A) the taxpayer's domestic production gross receipts (DPGR) for such taxable year, over (B) the sum of (i) the cost of goods sold (CGS) that are allocable to such receipts; and (ii) other expenses, losses, or deductions (other than the deduction under section 199) that are properly allocable to such receipts.

Section 199(c)(4)(A)(i) provides that the term DPGR means the taxpayer's gross receipts that are derived from any lease, rental, license, sale, exchange, or other disposition of (I) qualifying production property (QPP) that was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States; (II) any qualified film produced by the taxpayer; or (III) electricity, natural gas, or potable water produced by the taxpayer in the United States.

Section 199(c)(6) defines a qualified film to mean any property described in section 168(f)(3) if not less than 50 percent of the total compensation relating to production of the property is compensation for services performed in the United States by actors, production personnel, directors, and producers. The term does not include property with respect to which records are required to be maintained under 18 U.S.C. 2257 (generally, films, videotapes, or other matter that depict actual sexually explicit conduct and are produced in whole or in part with materials that have been mailed or shipped in interstate or foreign commerce, or are shipped or transported or are intended for shipment or transportation in interstate or foreign commerce).

Section 199(d)(4)(A) provides that all members of an expanded affiliated group (EAG) are treated as a single corporation for purposes of section 199. Under section 199(d)(4)(B), an EAG is an affiliated group as defined in section 1504(a), determined by substituting ''more than 50 percent'' for ''at least 80 percent'' each place it appears and without regard to section 1504(b)(2) and (4).

Qualified Film Produced by the Taxpayer

Under section 199(c)(4)(A)(i)(II), a taxpayer's gross receipts qualify as DPGR if the receipts are derived from any lease, rental, license, sale, exchange, or other disposition of any qualified film (as defined in section 199(c)(6)) produced by the taxpayer. A film must be both a ''qualified film'' under section 199(c)(6) and ''produced by the taxpayer'' under section 199(c)(4)(A)(i)(II) in order for the gross receipts to qualify as DPGR. However, as discussed in the preamble to the proposed regulations published on June 7, 2007 (72 FR 31478), the ''by the taxpayer'' compensation fraction in § 1.199–3(k)(5) in TD 9263 (71 FR 31268) may have resulted in a film that was produced entirely within the United States as not qualifying under section 199(c)(6) if less than 50 percent of the total compensation relating to production was paid ''by the taxpayer.''

This Treasury decision revises the ''by the taxpayer'' compensation fraction in § 1.199–3(k)(5) in TD 9263 (71 FR 31268) for determining the not-less-than-50-percent-of-the-total-compensation requirement under § 1.199–3(k)(1). Under the revised fraction in § 1.199–3(k)(5), the numerator of the revised fraction is the compensation for services performed in the United States and the denominator is the total compensation for services regardless of where the production activities are performed. The revised fraction essentially compares (in the numerator) the sum of the compensation for services paid by the taxpayer for services performed in the United States and the compensation for services paid by others for services performed in the United States to (in the denominator) the sum of the total compensation for services paid by the taxpayer for services and the total compensation for services paid by others for services regardless of location.

Under § 1.199–3(k)(6), a film that is a qualified film under § 1.199–3(k)(1) will be treated as ''produced by the taxpayer'' for purposes of section 199(c)(4)(A)(i)(II) if the production activity performed by the taxpayer is substantial in nature within the meaning of § 1.199–3(g)(2). Thus, a qualified film will be treated as produced by the taxpayer if the production of the qualified film by the taxpayer is substantial in nature taking into account all of the facts and circumstances, including the relative value added by, and relative cost of, the taxpayer's production activity, the nature of the qualified film, and the nature of the production activity that the taxpayer performs.

The revised fraction in § 1.199–3(k)(5) follows the statutory language in section 199(c)(6) by referencing all compensation for services related to the production as opposed to the more limited ''by the taxpayer'' compensation fraction in TD 9263 (71 FR 31268). Because taxpayers may have difficulty obtaining information related to the compensation paid by others, this Treasury decision provides a safe harbor in § 1.199–3(k)(7) that treats a film as a qualified film if not less than 50 percent of the total compensation for services paid by the taxpayer is compensation for services performed in the United States. The safe harbor further provides that a qualified film will be treated as produced by the taxpayer if the taxpayer satisfies the safe harbor in § 1.199–3(g)(3) with respect to the qualified film, which requires that the direct labor and overhead costs incurred by the taxpayer to produce the qualified film within the United States account for 20 percent or more of the total costs of the film. Thus, a taxpayer will be treated as having produced a qualified film if, in connection with the qualified film, the direct labor and overhead of the taxpayer to produce the qualified film within the United States account for 20 percent or more of the taxpayer's CGS of the qualified film, or in a transaction without CGS (for example, a lease, rental, or license) account for 20 percent or more of the taxpayer's ''unadjusted depreciable basis'' (as defined in § 1.199–3(g)(3)(ii)) in the qualified film.

Expanded Affiliated Groups

As discussed in the preamble to the proposed regulations published on June 7, 2007 (72 FR 31478), § 1.199–7(e), *Example 10*, in TD 9263 (71 FR 31268) misapplies § 1.1502–13 of the consolidated return regulations. Accordingly, § 1.199–7(e), *Example 10*, has been revised to correctly apply the consolidated return regulations. In addition, as also discussed in the preamble to the proposed regulations published on June 7, 2007 (72 FR 31478), the section 199 closing of the books method under § 1.199–7(f)(1)(ii) in TD 9263 (71 FR 31268) could have created a larger section 199 deduction than is warranted. Accordingly, this Treasury decision removes the section 199 closing of the books method and revises the *Example* in § 1.199–7(g)(3) to apply the pro rata allocation method.

Effective/Applicability Dates

Sections 1.199–3(k) and 1.199–7(e), *Example 10*, (f)(1), and (g)(3) are applicable to taxable years beginning on or after March 7, 2008. A taxpayer may apply §§ 1.199–3(k) and 1.199–7(e), *Example 10*, to taxable years beginning after December 31, 2004, and before March 7, 2008. However, for taxable years beginning before June 1, 2006, a taxpayer may rely on § 1.199–3(k) only if the taxpayer does not apply Notice 2005–14 (2005–1 CB 498) (see § 601.601(d)(2)(ii)(*b*)) or REG–105847–05 (2005–2 CB 987) (see § 601.601(d)(2)(ii)(*b*)) to the taxable year.

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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, 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, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is David H. McDonnell, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 * * *

■ **Par. 2.** Section 1.199–0 is amended by:

■ 1. Revising the entries for § 1.199–3(k)(6) and (7).

■ 2. Adding new entries for §§ 1.199–3(k)(7)(i) and (ii); (8), (9), and (10); and 1.199–8(i)(8) and (9).

■ 3. Removing the entries for § 1.199–7(f)(1)(i), (ii), and (iii).

The additions and revisions read as follows:

§ 1.199–0 Table of contents.

* * * * *

* * * * *

■ **Par. 3.** Section 1.199–3 is amended by:

■ 1. Revising paragraphs (k)(1), (k)(4), and (k)(5).

■ 2. Redesignating paragraph (k)(6) as (k)(9).

■ 3. Redesignating paragraph (k)(7) as (k)(10).

■ 4. Adding new paragraphs (k)(6), (k)(7), and (k)(8).

■ 5. Revising *Example 6* of newly redesignated paragraph (k)(10)

The revisions and additions read as follows:

§ 1.199–3 Domestic production gross receipts.

* * * * *

(k) *Definition of qualified film*—(1) *In general.* The term *qualified film* means any motion picture film or video tape under section 168(f)(3), or live or delayed television programming (film), if not less than 50 percent of the total compensation relating to the production of such film is compensation for services performed in the United States by actors, production personnel, directors, and producers. For purposes of this paragraph (k), the term *actors* includes players, newscasters, or any other persons who are compensated for their performance or appearance in a film. For purposes of this paragraph (k), the term *production personnel* includes writers, choreographers and composers who are compensated for providing services during the production of a film, as well as casting agents, camera operators, set designers, lighting technicians, make-up artists, and other persons who are compensated for providing services that are directly related to the production of the film. Except as provided in paragraph (k)(2) of this section, the definition of a qualified film does not include tangible personal property embodying the qualified film, such as DVDs or videocassettes.

* * * * *

(4) *Compensation for services.* For purposes of this paragraph (k), the term *compensation for services* means all payments for services performed by actors, production personnel, directors, and producers relating to the production of the film, including participations and residuals. Payments for services include all elements of compensation as provided for in § 1.263A–1(e)(2)(i)(B) and (3)(ii)(D). Compensation for services is not limited to W–2 wages and includes compensation paid to independent contractors. In the case of a taxpayer that uses the income forecast method of section 167(g) and capitalizes participations and residuals into the adjusted basis of the qualified film, the taxpayer must use the same estimate of participations and residuals in determining compensation for services. In the case of a taxpayer that excludes participations and residuals from the adjusted basis of the qualified film under section 167(g)(7)(D)(i), the taxpayer must use the amount expected to be paid as participations and residuals based on the total forecasted income used in determining income forecast depreciation in determining compensation for services.

(5) *Determination of 50 percent.* The not-less-than-50-percent-of-the-total-compensation requirement under paragraph (k)(1) of this section is calculated using a fraction. The numerator of the fraction is the compensation for services performed in the United States and the denominator is the total compensation for services regardless of where the production activities are performed. A taxpayer may use any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances, including all historic information available, to determine the compensation for services performed in the United States and the total compensation for services regardless of where the production activities are

performed. Among the factors to be considered in determining whether a taxpayer's method of allocating compensation is reasonable is whether the taxpayer uses that method consistently from one taxable year to another.

(6) *Produced by the taxpayer.* A qualified film will be treated as produced by the taxpayer for purposes of § 199(c)(4)(A)(i)(II) if the production activity performed by the taxpayer is substantial in nature within the meaning of paragraph (g)(2) of this section. The special rules of paragraph (g)(4) of this section regarding a contract with an unrelated person and aggregation apply in determining whether the taxpayer's production activity is substantial in nature. Paragraphs (g)(2) and (4) of this section are applied by substituting the term *qualified film* for QPP and disregarding the requirement that the production activity must be within the United States. The production activity of the taxpayer must consist of more than the minor or immaterial combination or assembly of two or more components of a film. For purposes of paragraph (g)(2) of this section, the relative value added by affixing trademarks or trade names as defined in § 1.197–2(b)(10)(i) will be treated as zero.

(7) *Qualified film produced by the taxpayer—safe harbor.* A film will be treated as a qualified film under paragraph (k)(1) of this section and produced by the taxpayer under paragraph (k)(6) of this section (qualified film produced by the taxpayer) if the taxpayer meets the requirements of paragraphs (k)(7)(i) and (ii) of this section. A taxpayer that chooses to use this safe harbor must apply all the provisions of this paragraph (k)(7).

(i) *Safe harbor.* A film will be treated as a qualified film produced by the taxpayer if not less than 50 percent of the total compensation for services paid by the taxpayer is compensation for services performed in the United States and the taxpayer satisfies the safe harbor in paragraph (g)(3) of this section. The special rules of paragraph (g)(4) of this section regarding a contract with an unrelated person and aggregation apply in determining whether the taxpayer satisfies paragraph (g)(3) of this section. Paragraphs (g)(3) and (4) of this section are applied by substituting the term *qualified film* for QPP but not disregarding the requirement that the direct labor and overhead of the taxpayer to produce the qualified film must be within the United States. Paragraph (g)(3)(ii)(A) of this section includes any election under section 181.

(ii) *Determination of 50 percent.* The not-less-than-50-percent-of-the-total-compensation requirement under paragraph (k)(7)(i) of this section is calculated using a fraction. The numerator of the fraction is the compensation for services paid by the taxpayer for services performed in the United States and the denominator is the total compensation for services paid by the taxpayer regardless of where the production activities are performed. For purposes of this paragraph (k)(7)(ii), the term *paid by the taxpayer* includes amounts that are treated as paid by the taxpayer under paragraph (g)(4) of this section. A taxpayer may use any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances, including all historic information available, to determine the compensation for services paid by the taxpayer for services performed in the United States and the total compensation for services paid by the taxpayer regardless of where the production activities are performed. Among the factors to be considered in determining whether a taxpayer's method of allocating compensation is reasonable is whether the taxpayer uses that method consistently from one taxable year to another.

(8) *Production pursuant to a contract.* With the exception of the rules applicable to an expanded affiliated group (EAG) under § 1.199–7 and EAG partnerships under § 1.199–3(i)(8), only one taxpayer may claim the deduction under § 1.199–1(a) with respect to any activity related to the production of a qualified film performed in connection with the same qualified film. If one taxpayer performs a production activity pursuant to a contract with another party, then only the taxpayer that has the benefits and burdens of ownership of the qualified film under Federal income tax principles during the period in which the production activity occurs is treated as engaging in the production activity.

*   *   *   *   *

(10) * * *

Example 6. X creates a television program in the United States that includes scenes from films licensed by X from unrelated persons Y and Z. Assume that Y and Z produced the films licensed by X. The not-less-than-50-percent-of-the-total-compensation requirement under paragraph (k)(1) of this section is determined by reference to all compensation for services paid in the production of the television program, including the films licensed by X from Y and Z, and is calculated using a fraction as described in paragraph (k)(5) of this section. The numerator of the fraction is the compensation for services performed in the United States and the denominator is the total compensation for services regardless of where the production activities are performed. However, for purposes of calculating the denominator, in determining the total compensation paid by Y and Z, X need only include the total compensation paid by Y and Z to actors, production personnel, directors, and producers for the production of the scenes used by X in creating its television program.

*   *   *   *   *

■ **Par. 4.** Section 1.199–7 is amended by:

■ 1. Revising *Example 10* of paragraph (e).

■ 2. Revising paragraphs (f)(1) and (g)(3).

The revisions read as follows:

§ 1.199–7 Expanded affiliated groups.

*   *   *   *   *

(e) * * *

Example 10. (i) *Facts.* Corporation P owns all of the stock of Corporations S and B. P, S, and B file a consolidated Federal income tax return on a calendar year basis. P, S, and B each uses the section 861 method for allocating and apportioning their deductions. In 2010, S MPGE QPP in the United States at a cost of $1,000. On November 30, 2010, S sells the QPP to B for $2,500. On February 28, 2011, P sells 60% of the stock of B to X, an unrelated person. On June 30, 2011, B sells the QPP to U, another unrelated person, for $3,000.

(ii) *Consolidated group's 2010 QPAI.* Because S and B are members of a consolidated group in 2010, pursuant to § 1.199–7(d)(1) and § 1.1502–13, neither S's $1,500 of gain on the sale of QPP to B nor S's $2,500 gross receipts from the sale are taken into account in 2010. Accordingly, neither S nor B has QPAI in 2010.

(iii) *Consolidated group's 2011 QPAI.* B becomes a nonmember of the consolidated group at the end of the day on February 28, 2011, the date on which P sells 60% of the B stock to X. Under § 1.199–7(d)(1) and § 1.1502–13(d), S takes the intercompany transaction into account immediately before B becomes a nonmember of the consolidated group. Pursuant to § 1.1502–13(d)(1)(ii)(A)(*1*), because the QPP is owned by B, a nonmember of the consolidated group immediately after S's gain is taken into account, B is treated as selling the QPP to a nonmember for $2,500, B's adjusted basis in the property, immediately before B becomes a nonmember of the consolidated group. Accordingly, immediately before B becomes a nonmember of the consolidated group, S takes into account $1,500 of QPAI (S's $2,500 DPGR received from B − S's $1,000 cost of MPGE the QPP).

(iv) *B's 2011 QPAI.* Pursuant to § 1.1502–13(d)(2)(i)(B), the attributes of B's corresponding item, that is, its sale of the QPP to U, are determined as if the S division (but not the B division) were transferred by the P, S, and B consolidated group (treated as a single corporation) to an unrelated person. Thus, S's activities in MPGE the QPP before the intercompany sale of the QPP to B continue to affect the attributes of B's sale of the QPP. As such, B is treated as having

MPGE the QPP. Accordingly, upon its sale of the QPP, B has $500 of QPAI (B's $3,000 DPGR received from U minus B's $2,500 cost of MPGE the QPP).

* * * * *

(f) *Allocation of income and loss by a corporation that is a member of the expanded affiliated group for only a portion of the year*—(1) *In general.* A corporation that becomes or ceases to be a member of an EAG during its taxable year must allocate its taxable income or loss, QPAI, and W–2 wages between the portion of the taxable year that it is a member of the EAG and the portion of the taxable year that it is not a member of the EAG. This allocation of items is made by using the pro rata allocation method described in this paragraph (f)(1). Under the pro rata allocation method, an equal portion of a corporation's taxable income or loss, QPAI, and W–2 wages for the taxable year is assigned to each day of the corporation's taxable year. Those items assigned to those days that the corporation was a member of the EAG are then aggregated.

* * * * *

(g) * * *

(3) *Example.* The following example illustrates the application of paragraphs (f) and (g) of this section:

Example. (i) *Facts.* Corporations X and Y, calendar year corporations, are members of the same EAG for the entire 2010 taxable year. Corporation Z, also a calendar year corporation, is a member of the EAG of which X and Y are members for the first half of 2010 and not a member of any EAG for the second half of 2010. During the 2010 taxable year, neither X, Y, nor Z joins in the filing of a consolidated Federal income tax return. Assume that X, Y, and Z each has W–2 wages in excess of the section 199(b) wage limitation for all relevant periods. In 2010, X has taxable income of $2,000 and QPAI of $600, Y has a taxable loss of $400 and QPAI of ($200), and Z has taxable income of $1,400 and QPAI of $2,400.

(ii) *Analysis.* Pursuant to the pro rata allocation method, $700 of Z's 2010 taxable income and $1,200 of Z's 2010 QPAI are allocated to the first half of the 2010 taxable year (the period in which Z is a member of the EAG) and $700 of Z's 2010 taxable income and $1,200 of Z's 2010 QPAI are allocated to the second half of the 2010 taxable year (the period in which Z is not a member of any EAG). Accordingly, in 2010, the EAG has taxable income of $2,300 (X's $2,000 + Y's ($400) + Z's $700) and QPAI of $1,600 (X's $600 + Y's ($200) + Z's $1,200). The EAG's section 199 deduction for 2010 is therefore $144 (9% of the lesser of the EAG's $2,300 of taxable income or $1,600 of QPAI). Pursuant to § 1.199–7(c)(1), this $144 deduction is allocated to X, Y, and Z in proportion to their respective QPAI. Accordingly, X is allocated $48 of the EAG's section 199 deduction, Y is allocated $0 of the EAG's section 199 deduction, and Z is allocated $96 of the EAG's section 199 deduction. For the second half of 2010, Z has taxable income of $700 and QPAI of $1,200. Therefore, for the second half of 2010, Z has a section 199 deduction of $63 (9% of the lesser of its $700 taxable income or $1,200 QPAI for the second half of 2010). Accordingly, X's 2010 section 199 deduction is $48, Y's 2010 section 199 deduction is $0, and Z's 2010 section 199 deduction is $159, the sum of the $96 section 199 deduction of the EAG allocated to Z for the first half of 2010 and Z's $63 section 199 deduction for the second half of 2010.

* * * * *

■ Par. 5. Section 1.199–8 is amended by:

■ 1. Adding two sentences at the end of paragraph (a).

■ 2. Adding new paragraphs (i)(8) and (i)(9).

The revisions and additions read as follows:

§ 1.199–8 Other rules.

(a) *In general.* * * * For purposes of §§ 1.199–1 through 1.199–9, use of terms such as *payment, paid, incurred,* or *paid or incurred* is not intended to provide any specific rule based upon the use of one term versus another. In general, the use of the term *payment, paid, incurred,* or *paid or incurred* is intended to convey the appropriate standard under the taxpayer's method of accounting.

* * * * *

(i) * * *

(8) *Qualified film produced by the taxpayer.* Section 1.199–3(k) is applicable to taxable years beginning on or after March 7, 2008. A taxpayer may apply § 1.199–3(k) to taxable years beginning after December 31, 2004, and before March 7, 2008. However, for taxable years beginning before June 1, 2006, a taxpayer may rely on § 1.199–3(k) only if the taxpayer does not apply Notice 2005–14 (2005–1 CB 498) (see § 601.601(d)(2)(ii)(*b*) of this chapter) or REG–105847–05 (2005–2 CB 987) (see § 601.601(d)(2)(ii)(*b*) of this chapter) to the taxable year.

(9) *Expanded affiliated groups.* Section 1.199–7(e), *Example 10,* (f)(1), and (g)(3) are applicable to taxable years beginning on or after March 7, 2008. A taxpayer may apply § 1.199–7(e), *Example 10,* to taxable years beginning after December 31, 2004, and before March 7, 2008.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

Approved: March 3, 2008.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY

DEPARTMENT OF JUSTICE

31 CFR Part 901

[A.G. Order No. 2918–2007]

Treasury RIN 1510–AA91
Justice RIN 1105–AB26

Standards for the Administrative Collection of Claims

AGENCIES: Department of the Treasury; Department of Justice.

ACTION: Interim rule with request for comments.

SUMMARY: The Federal Claims Collection Standards (FCCS), provide governmentwide debt collection procedures and policies for agencies collecting non-tax debts owed to the United States. This rule revises part 901, which specifies the order in which a federal agency is required to apply a partial or installment payment to the various components of a delinquent, non-tax debt owed to the United States. Under the current rule, payments are required to be applied first to penalties, then to administrative costs, then to interest, and last to principal. As revised, the rule would require agencies to apply payments first to administrative costs that are paid out of amounts collected from the debtor (referred to as ''contingency fees'') when such costs are added to the debt, second to penalties, third to administrative costs other than contingency fees, fourth to interest, and last to principal. Additionally, the term ''administrative charges'' is being replaced with ''administrative costs'' for consistency and clarity.

DATES: This rule is effective April 7, 2008. Comments must be received by April 7, 2008.

ADDRESSES: All comments should be addressed to Thomas Dungan, Policy Analyst, Debt Management Services, Financial Management Service, Department of the Treasury, 401 14th Street, SW., Room 435, Washington, DC 20227. A copy of this interim rule is being made available for downloading from the Financial Management Service Web site at the following address: *http://www.fms.treas.gov/debt.* Comments also may be sent electronically through *http://www.regulations.gov* using the electronic comment form provided on that site. An electronic copy of this document is also available at the *http://www.regulations.gov* Web site.

FOR FURTHER INFORMATION CONTACT: Thomas Dungan, Policy Analyst,