

inducement fee received with respect to the acquisition of a noneconomic residual interest in an applicable REMIC has not been recognized in full by the holder as of the time the holder sells, or otherwise disposes of, that residual interest in the applicable REMIC (in a transaction other than a transaction to which section 381(c)(4) applies), then the holder must include the unrecognized portion of the inducement fee in income at that time.

(e) *Safe harbors.* If inducement fees are recognized in accordance with a method described in this paragraph (e), that method complies with the requirements of paragraph (c) of this section.

(1) *The book method.* Under the book method, an inducement fee is recognized in accordance with the method of accounting, and over the same period, that is used by the taxpayer for financial reporting purposes (including consolidated financial statements to shareholders, partners, beneficiaries, other proprietors and for credit purposes), provided that the inducement fee is included in income for financial reporting purposes over a period that is not shorter than the period during which the applicable REMIC is expected to generate taxable income.

(2) *The modified REMIC regulatory method.* Under the modified REMIC regulatory method, the inducement fee is recognized ratably over the remaining anticipated weighted average life of the applicable REMIC as if the inducement fee were unrecognized gain being included in gross income under § 1.860F-2(b)(4)(iii).

(3) *Additional safe harbor methods.* The Commissioner, by revenue ruling or revenue procedure published in the Internal Revenue Bulletin, may provide additional safe harbor methods for recognizing inducement fees on noneconomic REMIC residual interests.

(f) *Method of accounting.* The treatment of inducement fees is a method of accounting to which the provisions of sections 446 and 481 and the regulations thereunder apply. A taxpayer is generally permitted to adopt a method of accounting for inducement fees that satisfies the requirements of paragraph (c) of this section. Once a taxpayer adopts a method of accounting for inducement fees, that method must be applied consistently to all inducement fees received in connection with noneconomic REMIC residual interests and may be changed only with the consent of the Commissioner, as provided by section 446(e) and the regulations and procedures thereunder.

(g) *Effective date.* This section is applicable for taxable years ending on or after the date this document is published as a final regulation in the **Federal Register**.

Par. 3. Section 1.860A-0 is amended by adding an entry in the outline for § 1.860C-1(d) to read as follows:

§ 1.860A-0 Outline of REMIC provisions.

* * * * *

§ 1.860C-1 Taxation of holders of residual interests.

* * * * *

(d) Treatment of REMIC inducement fees.

* * * * *

Par. 4. Section 1.860C-1 is amended by adding paragraph (d) to read as follows:

§ 1.860C-1 Taxation of holders of residual interests.

* * * * *

(d) For rules on the proper accounting for income from inducement fees, see § 1.446-6.

Par. 5. Section 1.863-0 is amended by:

1. Adding an entry for § 1.863-1(d).
2. Redesignating the entry for § 1.863-1(e) as § 1.863-1(f).
3. Adding a new entry for § 1.863-1(e).

The additions read as follows:

§ 1.863-0 Table of contents.

* * * * *

§ 1.863-1 Allocation of gross income.

* * * * *

(d) Scholarships, fellowship grants, grants, prizes and awards.
(e) REMIC inducement fees.

* * * * *

Par. 6. Section 1.863-1 is amended as follows:

1. Paragraph (e) is revised.
2. Paragraph (f) is added.

The revision and addition reads as follows:

§ 1.863-1 Allocation of gross income under section 863(a).

* * * * *

(e) *REMIC inducement fees.* An inducement fee (as defined in § 1.446-6(b)(2)) shall be treated as income from sources within the United States.

(f) *Effective dates.* The rules of paragraphs (a), (b) and (c) of this section will apply to taxable years beginning after December 30, 1996. However, taxpayers may apply the rules of paragraphs (a), (b) and (c) of this section for taxable years beginning after July 11, 1995, and on or before December 30, 1996. For years beginning before December 30, 1996, see § 1.863-1 (as

contained in 26 CFR part 1 revised as of April 1, 1996). See paragraph (d)(4) of this section for rules regarding the applicability date of paragraph (d) of this section. Paragraph (e) of this section is applicable for taxable years ending on or after the date this document is published as a final regulation in the **Federal Register**.

Robert E. Wenzel,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 03-18212 Filed 7-18-03; 8:45 am]

BILLING CODE 4830-01-P

DEPARTMENT OF TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-129709-03]

RIN 1545-BC34

Prohibited Allocations of Securities in an S Corporation

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations that provide guidance on identifying disqualified persons and determining whether a plan year is a nonallocation year under section 409(p) and on the definition of synthetic equity under section 409(p)(5). These proposed regulations would generally affect plan sponsors of, and participants in, ESOPs holding stock of Subchapter S corporations. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by October 20, 2003.

Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for November 20, 2003, at 10 a.m. must be received by October 30, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG-129709-03), room 5226, 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:RU (REG-129709-03), Courier's Desk, Internal Revenue