governments, in the aggregate, or by the private sector, of $120,000,000 or more (adjusted for inflation) in any one year, and will not significantly or uniquely affect small governments. Therefore, no actions were deemed necessary under the provisions of the Unfunded Mandates Reform Act of 1995.

Paperwork Reduction Act

With publication of the Interim Rule (72 FR 40738, July 25, 2007), DEA eliminated the current exemption for chemical mixtures with concentration limits of the List I chemicals ephedrine and/or pseudoephedrine of less than or equal to five percent. This means that all chemical mixtures containing the List I chemicals ephedrine and/or pseudoephedrine are regulated chemical mixtures, regardless of concentration limits.

Due to this change in the regulations, all persons who import, export, manufacture, or distribute chemical mixtures containing these two List I chemicals were required to register with DEA. They were also required to file reports regarding certain transactions, should certain criteria be met.

As the impact of this regulation was minimal, DEA made minor revisions to the OMB information collections entitled ''Application for Registration Under Domestic Chemical Diversion Control Act of 1993 and Renewal Application for Registration under Domestic Chemical Diversion Control Act of 1993'' (OMB control number 1117–0031, DEA Form 510), ''Report of Mail Order Transactions'' (OMB control number 1117–0033), and ''Import/Export Declaration for List I and List II Chemicals'' (OMB control number 1117–0023). DEA did not receive any comments regarding the number of persons who may be affected by this regulation. With publication of the Interim Rule, DEA received approval from the OMB to revise these information collections as discussed above.

Congressional Review Act

This Rule is not a major rule as defined by Section 804 of the Small Business Regulatory Enforcement Fairness Act of 1996 (Congressional Review Act). This Rule will not result in an annual effect on the economy of $100,000,000 or more; a major increase in costs or prices; or significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based companies to compete with foreign-based companies in domestic and export markets.

List of Subjects In 21 CFR Part 1310

Drug traffic control, Exports, Imports, List I and List II chemicals, Reporting and recordkeeping requirements.

Adoption as Final Rule

The Interim Rule amending part 1310 of Title 21 of the Code of Federal Regulations, which published in the **Federal Register** on July 25, 2007, at 72 FR 40738, is hereby adopted as a Final Rule without change.

Dated: June 27, 2008.

Michele M. Leonhart,

Deputy Administrator.

[FR Doc. E8–15704 Filed 7–9–08; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9413]

RIN 1545–BD19

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 468B of the Internal Revenue Code (Code). The regulations provide rules regarding the taxation of income earned on escrow accounts, trusts, and other funds used during deferred like-kind exchanges of property, and final regulations under section 7872 regarding below-market loans to facilitators of these exchanges. The 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: *Effective Date:* These regulations are effective *July 10, 2008.*

Applicability Dates: For dates of applicability, see §§ 1.468B–6(f), 1.7872–5(d), and 1.7872–16(g).

FOR FURTHER INFORMATION CONTACT: Concerning the final regulations under section 468B, Jeffrey T. Rodrick, (202) 622–4930; concerning the final regulations under section 7872, David B. Silber, (202) 622–3930 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) regarding the taxation of qualified escrow accounts, qualified trusts, and other escrow accounts, trusts, or funds used during section 1031 deferred exchanges of like-kind property, and of below-market loans to facilitators of these exchanges, under sections 468B(g) and 7872.

On February 7, 2006, a partial withdrawal of notice of proposed rulemaking, a notice of proposed rulemaking, and notice of public hearing were published in the **Federal Register** (REG–209619–93 and REG–113365–04, 71 FR 6231). A public hearing was held on June 6, 2006. A revised Initial Regulatory Flexibility Analysis (IRFA) for REG–113365–04 was published in the **Federal Register** on March 20, 2007 (72 FR 13055). Written and electronic comments responding to the notice of proposed rulemaking and the revised IRFA were received. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The comments and amendments are discussed below.

Explanation of Provisions and Summary of Comments

1. Definitions

The proposed regulations define *exchange funds* as relinquished property, cash, or cash equivalent that secures an obligation of the transferee to transfer replacement property, or proceeds from a transfer of relinquished property. A commentator suggested that the definition of exchange funds as relinquished property, cash, or cash equivalent that secures an obligation of the transferee to transfer replacement property should be deleted as confusing and unnecessary, because it is irrelevant whether amounts held in a qualified account or fund secure or are intended to secure the obligations of the transferee. The final regulations do not adopt this comment. This definition of exchange funds is necessary because it encompasses transactions contemplated in § 1.1031(k)–1(g)(3) in which, for example, a transferee of the relinquished property pays a deposit before the property is transferred, or a transferee of the relinquished property agrees to transfer replacement property and deposits funds to secure the obligations of the transferee (see § 1.468B–6(e), *Example 1*). The definition is an alternative to the definition of exchange funds as proceeds from a transfer of relinquished property, and does not create a requirement that exchange funds must secure the obligations of a transferee.

The proposed regulations define *transactional expenses* as the usual and customary expenses paid or incurred in connection with a deferred exchange, including the cost of land surveys, appraisals, title examinations, termite inspections, transfer taxes and recording fees. A commentator suggested that transactional expenses should be defined by reference to § 1.1031(k)–1(g)(7), which provides that ''transactional items'' are those items that relate to the disposition of the relinquished property or to the acquisition of replacement property and appear under local standards in the typical closing statements as the responsibility of a buyer or seller, such as commissions, prorated taxes, recording or transfer taxes, and title company fees. Therefore, for consistency, the final regulations provide that *transactional expenses* means transactional items described in § 1.1031(k)–1(g)(7)(ii). The final regulations retain special rules to determine whether fees paid to an exchange facilitator are transactional expenses.

2. Taxable Year of Receipt of Income

The proposed regulations omit an example in proposed regulations issued in 1999 that concluded that interest on a taxpayer's exchange funds is taxable in the year earned or credited rather than in a later year when the interest is paid. A commentator requested that the final regulations include a similar example. An example in the final regulations has been revised to illustrate this result.

Commentators suggested that the example in § 1.7872–16 of the proposed regulations conflicts with the constructive receipt rules of § 1.1031(k)–1(g)(6) because it posits that amounts are paid as compensation to the exchange facilitator, and are retransferred as imputed interest to the taxpayer, before the end of the exchange period. The final regulations do not adopt this comment. The example illustrates the mechanics of section 7872 in imputing interest and treating a corresponding amount as deemed compensation in the case of a compensation-related loan. This treatment is not inconsistent with § 1.1031(k)–1(g), which merely provides rules of administrative convenience under which, if certain requirements are satisfied, a taxpayer is deemed not to actually or constructively receive exchange funds or to have an agency relationship with an exchange facilitator solely for purposes of obtaining nonrecognition treatment under section 1031. For other taxation purposes, such as determining the timing for including earnings or imputed amounts in income, general tax principles apply, including timing principles under sections 7872 and 451. See § 1.1031(k)–1(n).

3. Earnings Attributable to Exchange Funds

The proposed regulations provide that exchange funds are treated, generally, as loaned by a taxpayer to an exchange facilitator, and the exchange facilitator takes into account all items of income, deduction, and credit. If, however, the escrow agreement, trust agreement, or exchange agreement specifies that all the earnings attributable to exchange funds are payable to the taxpayer, the exchange funds are not treated as loaned from the taxpayer to the exchange facilitator, and the taxpayer takes into account all items of income, deduction, and credit attributable to the exchange funds. If an exchange facilitator commingles taxpayers' exchange funds (whether or not a taxpayer's funds are held in a separate account) all earnings attributable to a taxpayer's exchange funds are treated as paid to the taxpayer if all of the earnings of the commingled funds, allocable on a pro rata basis to a taxpayer, are paid to the taxpayer.

a. Separately Identified Accounts

Commentators noted that many exchange facilitators have a corporate relationship with the institution in which the exchange facilitator deposits exchange funds on behalf of taxpayers and questioned whether, in addition to the stated earnings of the account in which the exchange funds are deposited, a portion of the earnings the depository institution receives in the ordinary course of investing customer deposits as part of its trade or business operations should be treated as earnings attributable to exchange funds if the depository institution is part of the same corporate group as the exchange facilitator. One group of commentators noted that it is common business practice for a depository institution in the same corporate group as an exchange facilitator to credit a portion of its revenues to the exchange facilitator based on the amount of exchange funds deposited by the exchange facilitator with the depository institution, and suggested that these types of internal credits should be treated as earnings attributable to exchange funds. However, other commentators argued that these internal credits are similar to payments a depository institution may make to an unrelated exchange facilitator for depositing funds with the depository institution and therefore, should not be treated as earnings attributable to exchange funds solely because the exchange facilitator is related to the depository institution. Some commentators noted that an exchange facilitator that maintains a master account that includes individual sub-accounts in taxpayers' names and taxpayer identification numbers (TIN) may earn additional interest in excess of the interest paid on the sub-accounts, based on the amounts the exchange facilitator deposits. To clarify what constitutes earnings attributable to the exchange funds, one commentator recommended that the final regulations provide that if exchange funds are held in a segregated account for the benefit of the taxpayer, only the earnings on the segregated account will be considered earnings attributable to the exchange funds. The commentator suggested that this rule would provide a simple, clear definition.

In response to these comments, the final regulations provide that, if exchange funds are held with a depository institution in an account (including a sub-account) that is separately identified with a taxpayer's name and TIN, only the earnings on the account are treated as earnings attributable to the exchange funds. The final regulations provide examples to illustrate the application of this rule to exchange facilitators related to depository institutions and to master/sub-account arrangements.

b. Commingled Accounts

A commentator opined that the proposed rules for allocating earnings in a commingled account are confusing because the rules apply ''whether or not the taxpayer's funds are in a segregated account.'' The commentator stated that, as a result, it is unclear whether all funds an exchange facilitator deposits in a specific depository institution constitute one commingled account, even if the funds are maintained in separate accounts and derive from financial transactions unrelated to exchange funds. The final regulations clarify that separate accounts maintained in the names and TINs of unrelated taxpayers do not constitute a commingled account.

c. Administrative Fees

Commentators suggested that fees paid by a bank to a related exchange facilitator should be treated as earnings attributable to exchange funds. Other commentators stated that these fees are compensation for administrative services provided and are not earnings attributable to the funds. The final regulations do not treat these fees as earnings attributable to exchange funds. Fees for administrative services provided by exchange facilitators to depository institutions represent compensation for services provided by the exchange facilitator as opposed to earnings on the exchange funds.

4. Loan Treatment

a. Characterization as Loan

Commentators opined that exchange funds should not be treated as loaned from the taxpayer to the exchange facilitator because an exchange facilitator's relationship with the taxpayer is primarily that of a fiduciary. A commentator suggested that exchange facilitators are similar to mortgage or payroll processing servicers that maintain interest-bearing escrow accounts. The commentator also argued that the receipt of exchange funds by an exchange facilitator is not a compensation-related loan because the amount of interest required to be imputed would be higher for a greater amount of funds or longer exchange period, although the exchange facilitator would provide no additional services. Another commentator noted that other transactions in which payment is made before services are provided, such as pre-payments to contractors, are not treated as loans. The commentator asserted that the transaction between an exchange facilitator and its customer is an installment sale rather than a loan. Other commentators argued that treating exchange funds as loaned is inconsistent with the regulations under section 1031, which generally require that a taxpayer must not have any benefit of the exchange funds during the exchange period to avoid actual or constructive receipt. Other commentators agreed that an exchange facilitator's use of exchange funds properly may be characterized as a compensation-related loan.

The final regulations retain the general rule that money held by an exchange facilitator in a deferred exchange is treated as loaned by the taxpayer to the exchange facilitator. When an exchange facilitator benefits from the use of the taxpayer's exchange funds, characterizing the exchange funds as having been loaned from the taxpayer to the exchange facilitator is consistent with the substance of the transaction and with the definition of loan in the legislative history of section 7872. See H.R. Rep. 98–861 at 1018 (1984).

b. Application of Section 7872

Under the proposed regulations, an exchange facilitator loan must be tested under section 7872 to determine whether it is a below-market loan for purposes of that section. The proposed regulations further provide that a taxpayer must use a special 182-day applicable Federal rate (AFR) to test whether an exchange facilitator loan is a below-market loan. If an exchange facilitator loan is a below-market loan, the loan is treated as a compensation-related loan that is not exempt from section 7872 as a loan without significant tax effect.

Commentators opined that these transactions should not be subject to section 7872 for reasons including the lack of a significant tax effect, exceptions provided under sections 483 and 1274 for short-term loans, the general exemption from section 7872 for certain accounts or withdrawable shares with a bank, the costs of complying with section 7872, and the lack of a tax avoidance purpose.

One suggestion submitted by commentators to mitigate the impact of section 7872 on smaller transactions was the adoption of a rule that would exempt certain exchange facilitator loans from section 7872. The final regulations include an exemption from section 7872 for exchange facilitator loans of $2 million or less while preserving the application of section 7872 for larger transactions. This exemption amount may be increased in future published guidance. The exemption is limited to loans that are 6 months or less in duration.

c. Special AFR

One group of commentators believed that the special AFR in the proposed regulations is unreasonably high and suggested a more appropriate test rate would be a demand deposit rate. Other commentators suggested that the special AFR rate in the proposed regulations was appropriate.

For purposes of section 7872, the test rate allowed under section 1274(d)(1)(D) must be calculated by reference to United States Treasury obligations, not demand deposit rates. See footnote 5 of H.R. Conf. Rep. No. 99–250 at 15 (1985). However, in response to these comments, the final regulations use a 91-day rate, which is the investment rate on a 13-week (generally, 91-day) Treasury bill determined on the issue date that is the same as the date the exchange facilitator loan is made or, if the two dates are not the same, the issue date that most closely precedes the date that the exchange facilitator loan is made. This rate is based on semi-annual compounding and may be found at *http://www.treasurydirect.gov/RI/OFBills.* Also, in recognition that the short-term AFR may be lower than the 91-day rate, the final regulations provide that taxpayers must apply the lower of the 91-day rate or the short-term AFR when testing or imputing payments on an exchange facilitator loan under section 7872.

5. Effective/Applicability Date

Commentators requested that the final regulations apply to exchange agreements entered into, rather than transfers of property made, after the publication of final regulations. Alternatively, commentators requested that the applicability of the final regulations be deferred to allow exchange facilitators sufficient time to make changes to accounting, control, and reporting systems and to revise exchange agreements to comply with the final regulations.

In response to these comments, the final regulations apply to transfers of relinquished property made, and to exchange facilitator loans issued, on or after October 8, 2008. For transfers of relinquished property made by taxpayers after August 16, 1986, but before October 8, 2008, the IRS will not challenge a reasonable, consistently applied method of taxation for earnings attributable to exchange funds.

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. A final regulatory flexibility analysis has been prepared for this final regulation under 5 U.S.C. 604. The analysis is set forth below under the heading ''Final Regulatory Flexibility Analysis.'' Pursuant to section 7805(f) of the Code, 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.

Final Regulatory Flexibility Analysis

Succinct Statement of the Need for, and Objectives of, the Final Regulations

These final regulations are issued under the authority of sections 7805, 468B(g), and 7872. Section 468B(g) 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.

The final regulations provide that exchange funds are treated, generally, as loaned by a taxpayer to an exchange facilitator, and the exchange facilitator takes into account all items of income, deduction, and credit. If, however, the escrow agreement, trust agreement, or exchange agreement specifies that all the earnings attributable to exchange funds are payable to the taxpayer, the exchange funds are not treated as loaned from the taxpayer to the exchange facilitator, and the taxpayer takes into account all items of income, deduction, and credit attributable to the exchange funds. The final regulations are intended to provide greater certainty, enhance administrability, and ensure consistent treatment of taxpayers. The final regulations contain amendments to ease the economic impact of the final regulations on small businesses.

Summary of Significant Issues Raised by Public Comments in Response to the Initial Regulatory Flexibility Analysis, Assessment of Issues, and Statement of Changes Made to the Proposed Regulations as a Result of Comments

a. Administrative Burden Resulting From Loan Characterization

Under the final regulations, if exchange funds are treated as loaned by the taxpayer to an 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. Therefore, exchange facilitators must keep records of the amount of income paid to a taxpayer and may be required to report the income on Forms 1099. The revised IRFA estimated that most small businesses subject to the proposed regulations currently maintain records of the amount of income paid to the taxpayer and report the payments on Forms 1099. The revised IRFA concluded that the proposed regulations should not increase significantly the compliance burden associated with keeping records and reporting income paid to the taxpayer, based on the expectation that the proposed regulations may have the effect of increasing the amount exchange facilitators report, but not result in a significant increase in the number of forms generated. The revised IRFA requested additional comments to assist in quantifying any additional recordkeeping burdens and accounting costs that may result.

A commentator responded that the proposed regulations impose new and different reporting requirements than those that currently apply to qualified intermediaries (QI) because QIs must determine if the regulations apply to a particular transaction and may be required to report imputed interest. The commentator provided a study (updated in a follow-up submission) that concludes that the incremental workload to comply with the proposed regulations is substantial and the software needed to comply with the recordkeeping requirements is not available at a cost affordable to many small businesses. The study offers suggestions to mitigate these effects that include providing an exception to section 7872 for certain transactions, revising the special AFR, and including a transition period. The final regulations incorporate all of these suggestions.

The study also suggested that the average daily balance calculations required under the proposed regulations create substantial administrative burdens and should be deleted. The final regulations do not adopt this comment. The final regulations do not require average daily balance calculations, but provide an example utilizing an average daily balance calculation as only one acceptable method to determine the earnings of a commingled account that are attributable to a taxpayer's exchange funds. No other comments were received quantifying a compliance burden resulting from the proposed regulations. A commentator advised that the amount of additional time or expense that would result from the application of the proposed regulations could not be quantified yet. However, commentators requested that the applicability of the final regulations be delayed to allow exchange facilitators sufficient time to make required changes to accounting, control, and reporting systems and to revise exchange agreements. In response to these comments, the final regulations apply to transfers of relinquished property made, and to exchange facilitator loans issued, on or after October 8, 2008.

b. Economic Impact of Loan Characterization

Commentators on the proposed regulations asserted that the loan characterization rules will cause a large number of small businesses to suffer a substantial revenue loss and to fail or reduce their workforces. They claimed that small business QIs would be disproportionately affected because these QIs predominantly apply a business model that would place them at a disadvantage under the proposed regulations. Commentators stated that if businesses are required to impute interest on exchange funds, taxpayers will demand that this interest be paid to them. To compensate for this loss of revenue, these commentators claim that small businesses will be required to change their business practices to pay all income to the taxpayer and to charge higher fees, while large, bank-affiliated QIs generally will be unaffected. The revised IRFA requested specific comments to assist in quantifying the number of businesses that would change their business model as a result of the proposed regulations and the effect a change in business model would have on revenues or profits. No comments quantifying this effect were received.

The revised IRFA also requested specific comments on the appropriateness and nature of a rule that would reduce the economic impact of the regulations on small businesses by exempting certain exchange transactions most likely to be engaged in by small businesses from loan treatment. For this purpose, the revised IRFA requested information on the average duration of exchange transactions and the average dollar amount of exchange funds.

A commentator responded that in its QI business 76 percent of exchange transactions closed within 60 days and 80 percent of exchange transactions involved less than $250,000 of exchange funds. This commentator advocated rules that would exempt from section 7872 transactions that either involved exchange funds of less than $250,000 or remained open for less than 60 days.

Another commentator cited the minimal revenue impact of allowing interest retained by a QI to escape income inclusion to the taxpayer as a reason supporting exempting certain deferred like-kind exchange transactions. Because compensation paid to a QI must be capitalized as an acquisition cost of the replacement property, the commentator asserted that there is only a timing mismatch for the taxpayer if current exclusion is not allowed, and that given the relatively short time period during which interest accrues in typical section 1031 transactions, any revenue impact of the proposed regulations would be outweighed by the increased compliance burden on taxpayers. This commentator suggested that two separate rules, one which exempts transactions of a certain amount ($1 million) and another which exempts transactions of short duration (less than

90 days), are necessary because the available data suggests that there is no correlation between the size of the deposited exchange funds and the length of time the funds stay on deposit. This commentator also requested that any exemption amounts be adjusted for inflation.

In response to these comments, the final regulations provide an exemption from section 7872 for exchange transactions in which the amount of exchange funds treated as loaned does not exceed $2 million and the funds are held for 6 months or less. This exemption amount may be increased in future published guidance. Based upon comments received the $2 million amount is expected to exempt from the application of section 7872 most deferred exchange transactions handled by small business exchange facilitators.

c. Special AFR

The proposed regulations provide a special AFR, equal to the investment rate on a 182-day Treasury bill, to test whether an exchange facilitator loan pays sufficient interest as required by section 7872. The special AFR was expected to result in fewer transactions requiring the imputation of interest to taxpayers than the short-term AFR, thus reducing the economic impact on small businesses. However, comments on the proposed regulations claimed that the special AFR is unrealistically high and inappropriate for these transactions. In order to determine an appropriate rate for testing exchange facilitator loans for sufficient interest, the revised IRFA requested specific comments identifying the rate of return typically earned by small business QIs on exchange funds and the interest rate QIs typically pay to taxpayers, and solicited suggestions for an appropriate rate.

A commentator responded that the rate of return earned by a QI will vary depending on the total amount of funds the QI aggregates, the market in which the QI operates, the QI's reputation and relationship with a depository institution, and the QI's choice of investment vehicle. Thus, the commentator advised that it is difficult to ascertain the rate of return earned by a small business QI on exchange funds. The commentator stated that quantifying the interest rate that QIs typically pay to taxpayers likewise is difficult because many factors influence it.

Another commentator responding to the revised IRFA argued that the 182-day rate is inappropriate to test whether exchange facilitator loans bear sufficient interest under section 7872 because exchange funds held by a depository institution are demand deposits and rarely are held for 180 days. This commentator identified three potential alternative rates to the 182-day rate for a special AFR: (1) A rate based on national demand deposit rates; (2) a rate that is 10 percent of an established rate such as the Federal Funds rate; and (3) an average of the minimum demand deposit savings rates offered by several banks in a QI's home office region. Although this commentator recognized the administrative burdens of publishing one of these alternative rates, the commentator believed these alternatives more readily reflected the economic reality of exchange fund transactions than the 182-day rate.

In response to these comments and comments on the proposed regulations, in lieu of the 182-day rate, the final regulations provide a special AFR that is the investment rate on a 13-week (generally, 91-day) Treasury bill. In addition, because the short-term AFR may be lower than the 91-day rate, the final regulations provide that taxpayers must apply the lower of the 91-day rate or the short-term AFR when testing for sufficient interest under section 7872.

d. Earnings Attributable to Exchange Funds

The proposed regulations provide that a taxpayer's exchange funds are not treated as loaned if all the earnings attributable to the exchange funds are paid to the taxpayer but do not define the term "earnings attributable to the exchange funds." Commentators have asserted that the lack of specificity results in disparate treatment of bank-affiliated QIs and independent QIs because of their different business models and places the independent QIs, many of which are small businesses, at an economic disadvantage.

Commentators advised that a portion of the earnings of a depository institution may be credited to an exchange facilitator based on the total amount of exchange funds the exchange facilitator deposits when the exchange facilitator and the depository institution (generally large businesses) are part of the same corporate group. The commentators opined that the proposed regulations do not, but should, treat this credit as earnings attributable to the exchange funds on which it is calculated.

Another commentator noted that depository institutions also may pay fees to unrelated exchange facilitators, including small businesses, for depositing exchange funds. Furthermore, other commentators described a business model used by some independent QIs, including some small businesses, in which a QI deposits the exchange funds of multiple taxpayers in sub-accounts under a master account that earns interest in addition to the interest credited to the sub-accounts. The amount of the additional interest credited to the QI is based on the total amount of exchange funds the QI deposits. Commentators have expressed concern that the proposed regulations treat this additional interest as earnings attributable to the individual taxpayers' exchange funds, but do not similarly treat earnings credited to a related QI based on total amount deposited.

The commentators claim that as a result of this treatment independent QIs will be forced to pay the additional interest that is attributable to exchange funds to taxpayers to avoid loan treatment, and thus will be required to correspondingly raise fees to compensate for lost profits. They assert that because bank-affiliated QIs earn profits by means of credits that are not attributed to exchange funds, bank-affiliated QIs will not be required to raise fees, creating an economic disparity between similarly situated bank-affiliated QIs and independent QIs.

In response to these comments, the final regulations provide a definitive test for determining earnings attributable to a taxpayer's exchange funds when an exchange facilitator holds all of the taxpayer's exchange funds in a separately identified account (or sub-account) under that taxpayer's name and TIN. Under this rule, the earnings attributable to the taxpayer's exchange funds include only the earnings on the separately identified account. This rule equalizes the treatment of independent, small business exchange facilitators and large exchange facilitators by providing that neither earnings of a depository institution that are credited to a related exchange facilitator nor the additional interest paid in connection with a master account are treated as earnings attributable to exchange funds when a taxpayer's exchange funds are held in a separately identified account (or sub-account).

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

The final regulations affect exchange facilitators that hold exchange funds for taxpayers engaging in deferred exchanges of like-kind property. The revised IRFA concludes that the applicable size standard for determining what constitutes a small business for purposes of the proposed regulations is

$2 million in annual gross receipts, the SBA's definition of a small business for North American Industry Classification System (NAICS) code 531390, and estimates that there are approximately 325 businesses (mostly QIs) that are full-time exchange facilitators.

The revised IRFA requested additional information on the number of small businesses engaged in the QI industry, and requested specific comments from QIs engaged exclusively in that business indicating whether their annual gross receipts are $2 million or less, or more than $2 million. A commentator advised that the number of QIs is very large, but many QIs do not identify themselves as such or engage in that business full-time. The commentator reported that the annual gross receipts of its QI business are well below $2 million. Another commentator opined that the information requested could not be quantified. No other comments were received on the number of small businesses in the industry or the general appropriateness of the size standard. Therefore, the estimate of approximately 325 businesses that are full-time exchange facilitators, the applicable size standard for determining what constitutes a small business with respect to these regulations of $2 million in annual gross receipts, and the conclusion that a significant portion of the QI industry consists of small businesses under this standard, are unchanged.

Description of Compliance Requirements and Estimate of the Classes of Small Businesses That Will Be Subject to the Compliance Requirements

As discussed, under current law exchange facilitators must keep records of the amount of income paid to taxpayers and may be required to report the income on Forms 1099. The final regulations provide that if the exchange funds are treated as loaned from the taxpayer to the QI and the loan is a below-market loan that does not qualify for an exemption from section 7872, income is deemed transferred to the exchange facilitator as compensation and retransferred to the taxpayer as interest. The exchange facilitator has income from the imputed compensation and an offsetting deduction for the interest deemed paid to the taxpayer.

The final regulations provide an exemption from section 7872 for exchange facilitator loans that do not exceed $2 million and provide that this exemption amount may be increased in future published guidance. Based on available data, this exemption from section 7872 is expected to apply to the majority of exchange transactions engaged in by small business exchange facilitators. Additionally, the final regulations revise the special AFR that determines whether a loan pays sufficient interest, which should reduce the number of transactions in which interest is imputed. Therefore, for most small businesses the final regulations are not expected to increase significantly the compliance burden associated with keeping records and reporting income paid to the taxpayer.

Actions To Minimize the Significant Economic Impact on Small Businesses and Reasons for Selecting Alternatives Reflected in the Final Regulations and for Rejecting Other Significant Alternatives

The final regulations provide a reasonable balance between the statutory requirements of sections 468B and 7872, the economic impact of a strict application of those provisions, and the need to provide clear and administrable rules. The inclusion of a $2 million exemption from section 7872, the adjustment of the special AFR, and the delayed applicability date reflect a judgment that the revenue effects are small and are outweighed by the compliance burden and other economic impacts of the regulations on small businesses.

Drafting Information

The principal authors of these regulations are Jeffrey T. Rodrick of the Office of Associate Chief Counsel (Income Tax & Accounting) and David B. Silber of the Office of Associate Chief Counsel (Financial Institutions & Products). 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 1.468B–6 also issued under 26 U.S.C. 468B(g). * * * Section 1.7872–5 also issued under 26 U.S.C. 7872. * * * Section 1.7872–16 also issued under 26 U.S.C. 7872. * * *

■ **Par. 2.** Section 1.468B–0 is amended by adding entries for § 1.468B–6 to read as follows:

§ 1.468B–0 Table of contents.

* * * * *

§ 1.468B–6 Escrow accounts, trusts, and other funds used during deferred exchanges of like-kind property under section 1031(a)(3).

* * * * *

■ **Par. 3.** Section 1.468B–6 is added to read as follows:

§ 1.468B–6 Escrow accounts, trusts, and other funds used during deferred exchanges of like-kind property under section 1031(a)(3).

(a) *Scope*. This section provides rules under section 468B(g) relating to the current taxation of escrow accounts, trusts, and other funds used during deferred exchanges.

(b) *Definitions*. The definitions in this paragraph (b) apply for purposes of this section.

(1) *In general. Deferred exchange, escrow agreement, escrow holder, exchange agreement, qualified escrow account, qualified intermediary, qualified trust, relinquished property, replacement property, taxpayer, trust agreement*, and *trustee* have the same meanings as in § 1.1031(k)–1; deferred exchange also includes any exchange intended to qualify as a deferred exchange, and qualified intermediary also includes any person or entity intended by a taxpayer to be a qualified intermediary within the meaning of § 1.1031(k)–1(g)(4).

(2) *Exchange funds. Exchange funds* means relinquished property, cash, or cash equivalent that secures an

obligation of a transferee to transfer replacement property, or proceeds from a transfer of relinquished property, held in a qualified escrow account, qualified trust, or other escrow account, trust, or fund in a deferred exchange.

(3) *Exchange facilitator. Exchange facilitator* means a qualified intermediary, transferee, escrow holder, trustee, or other party that holds exchange funds for a taxpayer in a deferred exchange pursuant to an escrow agreement, trust agreement, or exchange agreement.

(4) *Transactional expenses*—(i) *In general*. Except as provided in paragraph (b)(4)(ii) of this section, *transactional expenses* means transactional items within the meaning of § 1.1031(k)–1(g)(7)(ii).

(ii) *Special rule for certain fees for exchange facilitator services*. The fee for the services of an exchange facilitator is not a transactional expense unless the escrow agreement, trust agreement, or exchange agreement, as applicable, provides that—

(A) The amount of the fee payable to the exchange facilitator is fixed on or before the date of the transfer of the relinquished property by the taxpayer (either by stating the fee as a fixed dollar amount in the agreement or determining the fee by a formula, the result of which is known on or before the transfer of the relinquished property by the taxpayer); and

(B) The amount of the fee is payable by the taxpayer regardless of whether the earnings attributable to the exchange funds are sufficient to pay the fee.

(c) *Taxation of exchange funds*—(1) *Exchange funds generally treated as loaned to an exchange facilitator*. Except as provided in paragraph (c)(2) of this section, exchange funds are treated as loaned from a taxpayer to an exchange facilitator (exchange facilitator loan). If a transaction is treated as an exchange facilitator loan under this paragraph (c)(1), the exchange facilitator must take into account all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds. See § 1.7872–16 to determine if an exchange facilitator loan is a below-market loan for purposes of section 7872 and § 1.7872–5(b)(16) to determine if an exchange facilitator loan is exempt from section 7872.

(2) *Exchange funds not treated as loaned to an exchange facilitator*—(i) *Scope*. This paragraph (c)(2) applies if, in accordance with an escrow agreement, trust agreement, or exchange agreement, as applicable, all the earnings attributable to a taxpayer's exchange funds are paid to the taxpayer.

(ii) *Earnings attributable to the taxpayer's exchange funds*—(A) *Separately identified account*. If an exchange facilitator holds all of the taxpayer's exchange funds in a separately identified account, the earnings credited to that account are deemed to be all the earnings attributable to the taxpayer's exchange funds for purposes of paragraph (c)(2)(i) of this section. In general, a separately identified account is an account established under the taxpayer's name and taxpayer identification number with a depository institution. For purposes of paragraph (c)(2)(i) of this section, a sub-account will be treated as a separately identified account if the master account under which the sub-account is created is established with a depository institution, the depository institution identifies the sub-account by the taxpayer's name and taxpayer identification number, and the depository institution specifically credits earnings to the sub-account.

(B) *Allocation of earnings in commingled accounts*. If an exchange facilitator commingles (for investment or otherwise) the taxpayer's exchange funds with other funds or assets, all the earnings attributable to the taxpayer's exchange funds are paid to the taxpayer if all of the earnings attributable to the commingled funds or assets that are allocable on a pro-rata basis (using a reasonable method that takes into account the time that the exchange funds are in the commingled account, actual rate or rates of return, and the respective account balances) to the taxpayer's exchange funds either are paid to the taxpayer or are treated as paid to the taxpayer under paragraph (c)(2)(ii)(C) of this section.

(C) *Transactional expenses*. Any payment from the taxpayer's exchange funds, or from the earnings attributable to the taxpayer's exchange funds, for a transactional expense of the taxpayer (as defined in paragraph (b)(4) of this section) is treated as first paid to the taxpayer and then paid by the taxpayer to the recipient.

(iii) *Treatment of the taxpayer*. If this paragraph (c)(2) applies, exchange funds are not treated as loaned from a taxpayer to an exchange facilitator. The taxpayer must take into account all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds.

(d) *Information reporting requirements*. A payor (as defined in § 1.6041–1) must report the income attributable to exchange funds to the extent required by the information reporting provisions of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code, and the regulations under those provisions. See § 1.6041–1(f) for rules relating to the amount to be reported when fees, expenses or commissions owed by a payee to a third party are deducted from a payment.

(e) *Examples*. The provisions of this section are illustrated by the following examples in which T is a taxpayer that uses a calendar taxable year and the cash receipts and disbursements method of accounting. The examples are as follows:

Example 1. All earnings attributable to exchange funds paid to taxpayer. (i) T enters into a deferred exchange with R. The sales agreement provides that T will transfer property (the relinquished property) to R and R will transfer replacement property to T. R's obligation to transfer replacement property to T is secured by cash equal to the fair market value of the relinquished property, which R will deposit into a qualified escrow account that T establishes with B, a depository institution. T enters into an escrow agreement with B that provides that all the earnings attributable to the exchange funds will be paid to T.

(ii) On November 1, 2008, T transfers property to R and R deposits $2,100,000 in T's qualified escrow account with B. Between November 1 and December 31, 2008, B credits T's account with $14,000 of interest. During January 2009, B credits T's account with $7000 of interest. On February 1, 2009, R transfers replacement property worth $2,100,000 to T and B pays $2,100,000 from the qualified escrow account to R. Additionally, on February 1, 2009, B pays the $21,000 of interest to T.

(iii) Under paragraph (b) of this section, the $2,100,000 deposited with B constitutes exchange funds and B is an exchange facilitator. Because all the earnings attributable to the exchange funds are paid to T in accordance with the escrow agreement, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B. T must take into account in computing T's income tax liability for 2008 the $14,000 of earnings credited to the qualified escrow account in 2008 and for 2009 the $7,000 of earnings credited to the qualified escrow account in 2009.

Example 2. Payment of transactional expenses from earnings. (i) The facts are the same as in *Example 1*, except that the escrow agreement provides that, prior to paying the earnings to T, B may deduct any amounts B has paid to third parties for T's transactional expenses. B pays a third party $350 on behalf of T for a survey of the replacement property. After deducting $350 from the earnings attributable to T's qualified escrow account, B pays T the remainder ($20,650) of the earnings.

(ii) Under paragraph (b)(4) of this section, the cost of the survey is a transactional expense. Under paragraph (c)(2)(ii)(C) of this section, the $350 that B pays for the survey is treated as first paid to T and then from T to the third party. Therefore, all the earnings attributable to T's exchange funds are paid or treated as paid to T in accordance with the escrow agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B, and T must take into account in computing T's income tax liability the $21,000 of earnings credited to the qualified escrow account.

Example 3. Earnings retained by exchange facilitator as compensation for services. (i) The facts are the same as in *Example 1*, except that the escrow agreement provides that B also may deduct any outstanding fees owed by T for B's services in facilitating the deferred exchange. In accordance with paragraph (b)(4)(ii) of this section, the escrow agreement provides for a fixed fee of $1,200 for B's services, which is payable by T regardless of the amount of earnings attributable to the exchange funds. Because the earnings on the exchange funds in this case exceed $1,200, B retains $1,200 as the unpaid portion of its fee and pays T the remainder ($19,800) of the earnings.

(ii) Under paragraph (b)(4) of this section, B's fee is treated as a transactional expense. Under paragraph (c)(2)(ii)(C) of this section, the $1200 that B retains for its fee is treated as first paid to T and then from T to B. Therefore, all the earnings attributable to T's exchange funds are paid or treated as paid to T in accordance with the escrow agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B, and T must take into account in computing T's income tax liability the $21,000 of earnings credited to the qualified escrow account.

Example 4. Exchange funds deposited by exchange facilitator with related depository institution in account in taxpayer's name. (i) The facts are the same as in *Example 1* except that, instead of entering into an escrow agreement, T enters into an exchange agreement with QI, a qualified intermediary. The exchange agreement provides that R will pay $2,100,000 to QI, QI will deposit $2,100,000 into an account with a depository institution under T's name and taxpayer identification number (TIN), and all the earnings attributable to the account will be paid to T.

(ii) On May 1, 2008, T transfers property to QI, QI transfers the property to R, R delivers $2,100,000 to QI, and QI deposits $2,100,000 into a money market account with depository institution B under T's name and TIN. B and QI are members of the same consolidated group of corporations within the meaning of section 1501. Between May 1 and September 1, 2008, the account earns $28,000 of interest at the stated rate established by B. During the period May 1 to September 1, 2008, B invests T's exchange funds and earns $40,000. On September 1, 2008, QI uses $2,100,000 of the funds in the account to purchase replacement property identified by T and transfers the replacement property to T. B pays to T the $28,000 of interest earned on the money market account at the stated rate.

(iii) Under paragraph (b) of this section, the $2,100,000 QI receives from R for the relinquished property is exchange funds and QI is an exchange facilitator. B is not an exchange facilitator. T has not entered into an escrow agreement, trust agreement, or exchange agreement with B, and QI, not B, holds the exchange funds on behalf of T. Under paragraph (c)(2)(ii)(A) of this section, the $40,000 B earns from investing T's exchange funds are not treated as earnings attributable to T's exchange funds. Because all the earnings attributable to T's exchange funds are paid to T in accordance with the exchange agreement, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2008 the $28,000 of interest earned on the money market account.

Example 5. Earnings of related depository institution credited to exchange facilitator. (i) The facts are the same as in *Example 4*, except that at the end of each taxable year, B credits a portion of its earnings on deposits to QI. The amount credited is based on the total amount of exchange funds QI has deposited with B during the year. At the end of the 2008 taxable year, B credits $152,500 of B's earnings to QI.

(ii) Under paragraph (c)(2)(ii)(A) of this section, no part of the $152,500 credited by B to QI is earnings attributable to T's exchange funds. Therefore, all of the earnings attributable to the exchange funds are paid to T in accordance with the exchange agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2008 the $28,000 of interest earned on T's account.

Example 6. Exchange funds deposited by exchange facilitator with unrelated depository institution in sub-account in taxpayer's name. (i) The facts are the same as in *Example 4*, except that QI and B are unrelated and the money market account in which QI deposits the $2,100,000 received from T is a sub-account within a master account QI maintains with B in QI's name and TIN. The master account includes other sub-accounts, each in the name and TIN of a taxpayer that has entered into an exchange agreement with QI, into which QI deposits each taxpayer's exchange funds. Each month, B transfers to QI's master account an additional amount of interest based upon the average daily balance of all exchange funds within the master account during the month. At the end of the 2008 taxable year, B has credited $152,500 of additional interest to QI.

(ii) Under paragraph (c)(2)(ii)(A) of this section, no part of the $152,500 credited by B to QI is earnings attributable to T's exchange funds. Therefore, all of the earnings attributable to the exchange funds are paid to T in accordance with the exchange agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2008 the $28,000 of interest earned on T's account.

Example 7. Marketing fee paid to exchange facilitator. (i) The facts are the same as in *Example 4*, except that at the end of each taxable year, B pays a marketing fee to QI for using B as its depository institution for exchange funds. The amount of the fee is based on the total amount of exchange funds QI has deposited with B during the year.

(ii) Under paragraph (c)(2)(ii)(A) of this section, no part of the marketing fee that B pays to QI is earnings attributable to T's exchange funds. Therefore, all of the earnings attributable to the exchange funds are paid to T in accordance with the exchange agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2008 the $28,000 of interest earned on T's account.

Example 8. Stated rate of interest on account less than earnings attributable to exchange funds. (i) The facts are the same as in *Example 4*, except that the exchange agreement provides only that QI will pay T a stated rate of interest. QI invests the exchange funds and earns $40,000. The exchange funds earn $28,000 at the stated rate of interest, and QI pays the $28,000 to T.

(ii) Paragraph (c)(1) of this section applies and the exchange funds are treated as loaned from T to QI. QI must take into account in computing QI's income tax liability all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds. Paragraph (c)(2) of this section does not apply because QI does not pay all the earnings attributable to the exchange funds to T. See §§ 1.7872–5 and 1.7872–16 for rules relating to exchange facilitator loans.

Example 9. All earnings attributable to commingled exchange funds paid to taxpayer. (i) The facts are the same as in *Example 4*, except that the exchange agreement does not specify how the $2,100,000 QI receives from R must be invested.

(ii) On May 1, 2008, QI deposits the $2,100,000 with B in a pre-existing interest-bearing account under QI's name and TIN. The account has a total balance of $5,275,000 immediately thereafter. On the last day of each month between May and September, 2008, the account earns interest as follows: $17,583 in May, $17,642 in June, $18,756 in July, and $17,472 in August. On July 11, 2008, QI deposits $500,000 in the account. On August 15, 2008, QI withdraws $1,175,000 from the account.

(iii) QI calculates T's pro-rata share of the earnings allocable to the $2,100,000 based on the actual return, the average daily principal balances, and a 30-day month convention, as follows:

Month	Account's avg. daily bal.	T's avg. daily bal.	T's share* (percent)	Monthly interest	T's end. bal.**
May	$5,275,000	$2,100,000	39.8	$17,583	$2,106,998

Month	Account's avg. daily bal.	T's avg. daily bal.	T's share* (percent)	Monthly interest	T's end. bal.**
June	5,292,583	2,106,998	39.8	17,642	2,114,020
July	5,643,558	2,114,020	37.5	18,756	2,121,054
August	5,035,647	2,121,054	42.1	17,472	2,128,410

* T's Average Daily Balance ÷ Account's Average Daily Balance.
** T's beginning balance + [(T's share) (Monthly Interest)].

(iv) On September 1, 2008, QI uses $2,100,000 of the funds to purchase replacement property identified by T and transfers the property to T. QI pays $28,410, the earnings of the account allocated to T's exchange funds, to T.

(v) Because QI uses a reasonable method to calculate the pro-rata share of account earnings allocable to T's exchange funds in accordance with paragraph (c)(2)(ii)(B) of this section, and pays all those earnings to T, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI. T must take into account in computing T's income tax liability for 2008 the $28,410 of earnings attributable to T's exchange funds.

(f) *Effective/applicability dates*—(1) *In general*. This section applies to transfers of relinquished property made by taxpayers on or after October 8, 2008.

(2) *Transition rule*. With respect to transfers of relinquished property made by taxpayers after August 16, 1986, but before October 8, 2008, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income attributable to exchange funds.

■ **Par. 4.** Section 1.1031(k)–1 is amended by adding a sentence at the end of paragraph (h)(2) to read as follows:

§ 1.1031(k)–1 Treatment of deferred exchanges.

*   *   *   *   *

(h) * * *

(2) * * * For rules under section 468B(g) relating to the current taxation of qualified escrow accounts, qualified trusts, and other escrow accounts, trusts, and funds used during deferred exchanges of like-kind property, see § 1.468B–6.

*   *   *   *   *

■ **Par. 5.** Section 1.7872–5 is added to read as follows:

§ 1.7872–5 Exempted loans.

(a) *In general*—(1) *General rule*. Except as provided in paragraph (a)(2) of this section, notwithstanding any other provision of section 7872 and the regulations under that section, section 7872 does not apply to the loans listed in paragraph (b) of this section because the interest arrangements do not have a significant effect on the Federal tax liability of the borrower or the lender.

(2) *No exemption for tax avoidance loans*. If a taxpayer structures a transaction to be a loan described in paragraph (b) of this section and one of the principal purposes of so structuring the transaction is the avoidance of Federal tax, then the transaction will be recharacterized as a tax avoidance loan as defined in section 7872(c)(1)(D).

(b) *List of exemptions*. Except as provided in paragraph (a) of this section, the following transactions are exempt from section 7872:

(1) through (15) [Reserved]. For further guidance, see § 1.7872–5T(b)(1) through (15).

(16) An exchange facilitator loan (within the meaning of § 1.468B–6(c)(1)) if the amount of the exchange funds (as defined in § 1.468B–6(b)(2)) treated as loaned does not exceed $2,000,000 and the duration of the loan is 6 months or less. The Commissioner may increase this $2,000,000 loan exemption amount in published guidance of general applicability, see § 601.601(d)(2) of this chapter.

(c) [Reserved]. For further guidance, see § 1.7872–5T(c).

(d) *Effective/applicability date*. This section applies to exchange facilitator loans issued on or after October 8, 2008.

■ **Par. 6.** Section 1.7872–16 is added to read as follows:

§ 1.7872–16 Loans to an exchange facilitator under § 1.468B–6.

(a) *Exchange facilitator loans*. This section provides rules in applying section 7872 to an exchange facilitator loan (within the meaning of § 1.468B–6(c)(1)). For purposes of this section, the terms *deferred exchange, exchange agreement, exchange facilitator, exchange funds, qualified intermediary, replacement property*, and *taxpayer* have the same meanings as in § 1.468B–6(b).

(b) *Treatment as demand loans*. For purposes of section 7872, except as provided in paragraph (d) of this section, an exchange facilitator loan is a demand loan.

(c) *Treatment as compensation-related loans*. If an exchange facilitator loan is a below-market loan, the loan is a compensation-related loan under section 7872(c)(1)(B).

(d) *Applicable Federal rate (AFR) for exchange facilitator loans*. For purposes of section 7872, in the case of an exchange facilitator loan, the applicable Federal rate is the lower of the short-term AFR in effect under section 1274(d)(1) (as of the day on which the loan is made), compounded semiannually, or the 91-day rate. For purposes of the preceding sentence, the 91-day rate is equal to the investment rate on a 13-week (generally 91-day) Treasury bill with an issue date that is the same as the date that the exchange facilitator loan is made or, if the two dates are not the same, with an issue date that most closely precedes the date that the exchange facilitator loan is made.

(e) *Use of approximate method permitted*. The taxpayer and exchange facilitator may use the approximate method to determine the amount of forgone interest on any exchange facilitator loan.

(f) *Exemption for certain below-market exchange facilitator loans*. If an exchange facilitator loan is a below-market loan, the loan is not eligible for the exemptions from section 7872 listed under § 1.7872–5T. However, the loan may be eligible for the exemption from section 7872 under § 1.7872–5(b)(16) (relating to exchange facilitator loans in which the amount treated as loaned does not exceed $2,000,000).

(g) *Effective/applicability date*. This section applies to exchange facilitator loans issued on or after October 8, 2008.

(h) *Example*. The provisions of this section are illustrated by the following example:

Example. (i) T enters into a deferred exchange with QI, a qualified intermediary. The exchange is governed by an exchange agreement. The exchange funds held by QI pursuant to the exchange agreement are treated as loaned to QI under § 1.468B–6(c)(1). The loan between T and QI is an exchange facilitator loan. The exchange agreement between T and QI provides that no earnings will be paid to T. On December 1, 2008, T transfers property to QI, QI transfers the property to a purchaser for $2,100,000, and QI deposits $2,100,000 in a money market account. On March 1, 2009, QI uses $2,100,000 of the funds in the account to purchase replacement property identified by T, and transfers the replacement property to T. The amount loaned for purposes of section 7872 is $2,100,000 and the loan is outstanding for three months. For purposes of section 7872, under paragraph (d) of this section, T uses the 91-day rate, which is 4 percent, compounded semi-annually. T uses the approximate method for purposes of section 7872.

(ii) Under paragraphs (b) and (c) of this section, the loan from T to QI is a compensation-related demand loan. Because there is no interest payable on the loan from T to QI, the loan is a below-market loan under section 7872. The loan is not exempt under § 1.7872–5(b)(16) because the amount treated as loaned exceeds $2,000,000. Under section 7872(e)(2), the amount of forgone interest on the loan for 2008 is $7000 ($2,100,000*.04/2*1/6). Under section 7872(e)(2), the amount of forgone interest for 2009 is $14,000 ($2,100,000*.04/2*2/6). The $7000 for 2008 is deemed transferred as compensation by T to QI and retransferred as interest by QI to T on December 31, 2008. The $14,000 for 2009 is deemed transferred as compensation by T to QI and retransferred as interest by QI to T on March 1, 2009.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

Approved: July 2, 2008.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. E8–15739 Filed 7–9–08; 8:45 am]

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FEDERAL COMMUNICATIONS COMMISSION

47 CFR Part 73

[MB Docket No. 07–91; FCC 08–141]

Third Periodic Review of the Commission's Rules and Policies Affecting the Conversion to Digital Television

AGENCY: Federal Communications Commission.

ACTION: Final rule.

SUMMARY: In this document, the Commission provides clarification in connection with two issues addressed in the Report and Order. The Commission will address other issues raised in Petitions for Reconsideration in a future order. The Commission adopted a Report and Order in the Third DTV Periodic Review of the progress of the DTV transition. MSTV and NAB filed a joint petition for reconsideration requesting clarification of two issues in connection with the Order.

DATES: Effective July 10, 2008.

ADDRESSES: Federal Communications Commission, 445 12th Street, SW., Washington, DC 20554.

FOR FURTHER INFORMATION CONTACT: For additional information, please contact Kim Matthews, *Kim.Matthews@fcc.gov,* 202–418–2120.

SUPPLEMENTARY INFORMATION: This is a summary of the Commission's Order in MB Docket No. 07–91, FCC 08–141, adopted May 29, 2008 and released May 29, 2008. The full text of this document is available for public inspection and copying during regular business hours in the FCC Reference Center, Federal Communications Commission, 445 12th Street, SW., CY–A257, Washington, DC 20554. These documents will also be available via ECFS (*http://www.fcc.gov/cgb/ecfs/*). (Documents will be available electronically in ASCII, Word 97, and/or Adobe Acrobat.) The complete text may be purchased from the Commission's copy contractor, 445 12th Street, SW., Room CY–B402, Washington, DC 20554. To request this document in accessible formats (computer diskettes, large print, audio recording, and Braille), send an e-mail to *fcc504@fcc.gov* or call the Commission's Consumer and Governmental Affairs Bureau at (202) 418–0530 (voice), (202) 418–0432 (TTY).

Summary of the Order

1. In this Order, the Commission provides clarification in connection with two issues addressed in the Report and Order in the Third DTV Periodic Review proceeding. The Commission will address other issues raised in Petitions for Reconsideration in a future order. On December 22, 2007, the Commission adopted a Report and Order in the Third DTV Periodic Review, 73 FR 5634, January 30, 2008, of the progress of the DTV transition. MSTV and NAB filed a joint petition for reconsideration requesting clarification of two issues in connection with the Order. *See* Petition for Reconsideration and Clarification of the Association for Maximum Service Television, Inc. and the National Association of Broadcasters, filed February 29, 2008 (MSTV/NAB Petition).

2. First, MSTV/NAB sought clarification that where more than one of the Commission's viewer notification obligations adopted in the Order is triggered, a station may comply with the Commission's requirements through use of a consolidated notification that includes all of the elements required in each of the viewer notification obligations. There was nothing in the Third DTV Periodic to indicate that separate notifications are required by a station that is obligated to inform its viewers of changes in its analog or digital service during the same time frame. Stations must notify viewers in the following circumstances: (1) When the station is seeking an extension of time to construct post-transition facilities and will not be serving on February 18, 2009 at least the same population that receives the station's current analog TV and DTV service (*see Third DTV Periodic Report and Order,* 23 FCC Rcd at 3033, ¶ 80); (2) when the station will not be serving on February 18, 2009 at least the same population that receives its current analog TV and DTV service and is seeking STA approval to use one of the provisions for a phased transition (*see id.* at 3037–38, ¶ 91); (3) when the station will permanently reduce or terminate analog service thirty days or less prior to the transition deadline (*see id.* at 3044, ¶ 106); (4) when the station is seeking approval for longer term (significantly more than 30 days) reduction or termination of analog service before the transition date (*see id.* at 3050, ¶ 117); and (5) where a station on channels 52–58 seeks to flash cut and to terminate analog or digital service on its out-of-core channel (*see id.* at 3057–58, ¶ 132). In addition, stations seeking to permanently reduce or terminate analog service within 90 days of the transition date have a more streamlined viewer notification procedure (*see id.* at 3058, ¶ 134). No one filed an opposition to this MSTV/NAB request for clarification. We hereby clarify that we will permit use of such a consolidated notification in circumstances in which the Commission approves service adjustments that overlap in time. Indeed, we believe it could be confusing for viewers to hear multiple notifications that seem to conflict. Stations that prefer to have separate notifications for separate service adjustments may take that approach, as well, provided they offer clear information to viewers. We remind stations that Viewer Notification requirements are in addition to and not instead of the consumer education requirements that apply to all full power broadcasters. *See In the Matter of DTV Consumer Education Initiative,* Report and Order, 23 FCC Rcd 4134 (2008) (''*DTV Consumer Education Order*''), recon. order adopted April 23, 2008 (FCC 08–119). *See also Third DTV Periodic Report and Order,* 23 FCC Rcd at 3033, ¶ 80, 3037–38, ¶ 91, 3044, ¶ 106, 3057–58, ¶ 132, and 3058, ¶ 134.

3. Second, MSTV/NAB ask that the Commission acknowledge that real-time updates to the Event Information Table (EIT) are permissive and not required under the new PSIP standard adopted in the Order. No party opposed this request for clarification. John Willkie,