500 shares of stock in the new corporation.

In Situation 1, the ruling holds that the individual who transferred the business property to the corporation and the investors in the public offering were co-transferors in a single transaction that qualified under section 351. In Situation 2, the ruling holds that the firm commitment underwriter was a transferor along with the individual and that their control was not defeated by the subsequent resale of 50 percent of the stock in the public offering.

The IRS and Treasury believe that Situation 2 of Rev. Rul. 78–294 does not reflect current underwriting practices. In addition, the IRS and Treasury believe that underwritings of partnership interests should be treated similarly to underwritings of stock. Further, the proposed regulations are necessary to prevent inappropriate imposition and inappropriate avoidance of tax.

The proposed regulations, under certain circumstances, disregard underwriters of stock and partnership interests for purposes of section 351 and section 721. The proposed treatment of underwriters is similar to their treatment under § 1.382–3(j)(7) and § 1.1273–2(e).

Explanation of Provisions

Proposed Amendment Adding § 1.351–1(a)(3)

This document proposes to add § 1.351–1(a)(3) to 26 CFR part 1. The proposed regulation provides that, for the purpose of section 351, if a person acquires stock from an underwriter in exchange for cash in a qualified underwriting transaction, the person who acquires the stock from the underwriter is treated as transferring cash directly to the corporation in exchange for the stock and the underwriter is disregarded. A qualified underwriting transaction is a transaction in which a corporation issues stock for cash in an underwriting in which either the underwriter is an agent of the corporation or the underwriter's ownership of stock is transitory. The proposed regulation would render Rev. Rul. 78-294 obsolete. No inference is intended as to transactions not within the scope of the proposed regulation.

Proposed Amendment Adding § 1.721–1(c)

This document proposes to add § 1.721–1(c) to 26 CFR part 1. The proposed regulation provides that, for the purpose of section 721, if a person acquires a partnership interest from an underwriter in exchange for cash in a

qualified underwriting transaction, the person who acquires the partnership interest from the underwriter is treated as transferring cash directly to the partnership in exchange for the partnership interest and the underwriter is disregarded. A qualified underwriting transaction is a transaction in which a partnership issues partnership interests for cash in an underwriting in which either the underwriter is an agent of the partnership or the underwriter's ownership of the partnership interests is transitory. No inference is intended as to transactions not within the scope of the proposed regulation.

Comments Solicited

The IRS and Treasury invite public comment on the proposed regulations. In particular, the IRS and Treasury solicit comments on (a) whether the proposed rules should apply for all tax purposes; (b) whether the proposed rules should be limited to underwriters; and (c) whether the proposed rules should be limited to cash transactions.

Proposed Effective Dates

New § 1.351–1(a)(3) and new § 1.721–1(c) are proposed to be effective for qualified underwriting transactions occurring on or after the date of publication as final regulations in the **Federal Register**.

Effect on Other Documents

The following publication would become obsolete as of the date of publication in the **Federal Register** of the final regulations: Rev. Rul. 78–294, 1978–2 C.B. 141.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small **Business Administration for comment** on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the Internal Revenue Service. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Wednesday, January 17, 1996, beginning at 10 a.m., in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments, an outline of topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by Wednesday, December 27, 1995.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Susan T. Edlavitch of the Office of Assistant Chief Counsel (Corporate) and Brian J. O'Connor of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.351–1 also issued under 26 U.S.C. 351. * * *
Section 1.721–1 also issued under 26 U.S.C. 721. * *

Par. 2. In § 1.351–1, paragraph (a)(3) is added to read as follows:

§1.351–1 Transfer to corporation controlled by transferor.

(a) * * *

(3) *Underwritings of stock*—(i) *In general.* For the purpose of section 351,