

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 97-19, page 11.

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for May 1997.

T.D. 8715, page 5.

REG-209785-95, page 46.

Final, temporary, and proposed regulations under section 274 of the Code relate to the requirement that business expenses for travel, entertainment, gifts, or listed property be substantiated by documentary evidence (such as a receipt).

EXEMPT ORGANIZATIONS

Rev. Rul. 97-21, page 8.

Tax consequences of physician recruitment incentives provided by hospitals described in section 501(c)(3) of the Code. This ruling provides examples illustrating whether nonprofit hospitals that provide incentives to physicians to join their medical staffs or to provide medical services in the community violate the requirements for exemption as organizations described in section 501(c)(3) of the Code.

Announcement 97-46, page 53.

A list is given of organizations now classified as private foundations.

EXCISE TAX

P.L. 105-2, page 14.

An Act to amend the Internal Revenue Code of 1986 to reinstate the Airport and Airway Trust Fund excise taxes, and other purposes.

ADMINISTRATIVE

REG-209823-96, page 47.

Proposed regulations under sections 664 and 2707 of the Code relate to guidance regarding charitable remainder trusts and transfers of interests in trusts. A public hearing will be held on September 9, 1997.

Notice 97-28, page 45.

Credit for producing fuel from a nonconventional source, section 29 inflation adjustment factor, and section 29 reference price. This notice publishes the section 29 inflation adjustment factor, the nonconventional source fuel credit, and the section 29 reference price for calendar year 1996.

Finding Lists begin on page 58.

Index for January—April begins on page 60.

Announcements of Disbarments and Suspensions begin on page 56.

Announcement Relating to Court Decisions on page 4.

Announcement of Declaratory Judgment Proceedings Under Section 7428 on page 53.

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the

quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semi-annually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

For sale by the Superintendent of Documents U.S. Government Printing Office, Washington, D.C. 20402.

Announcement Relating to Court Decisions

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both “acqui-

escence” and “acquiescence in result only” mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, “acquiescence” indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, “acquiescence in result only” indicates disagreement or concern with some or all of those reasons. Nonacquiescence signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a nonacquiescence indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year, and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Buckeye Countrymark v. Commissioner,¹
103 T.C. 547 (1994)

Robert E. and Geneva U. Duncan v. United States,²
Docket No. 95–338

Cheng C. and Susan L. Kao v. United

¹Acquiescence relating to whether section 277 of the Internal Revenue Code applies to nonexempt cooperatives subject to subchapter T of the Code.

States,³

81 F.3d 114 (9th Cir. 1996)

The Commissioner does NOT ACQUIESCE in the following decisions:

Xerox Corporation v. United States,⁴
41 F.3d 647 (Fed. Cir. 1994)

Charles E. Hurt v. United States,⁵
70 F.3d 1261, 76 AFTR2d 95–7815 (4th Cir. 1995)

Robert B. and Eleanor Risman v. Commissioner,⁶
100 T.C. 191 (1993)

²Acquiescence relating to whether disability benefits paid to taxpayer from the Policemen and Firefighter’s Retirement Fund of the Lexington-Fayette Urban County Government can be excluded from gross income under Internal Revenue Code section 104(a)(1) as benefits paid under a statute in the nature of a workmen’s compensation act.

³Acquiescence in result only relating to whether the Service can issue summonses to compel a taxpayer to sign consent directives which authorize the release of records from unidentified domestic and foreign banks, consistent with the requirements of Internal Revenue Code section 7609.

⁴Nonacquiescence relating to whether, under Article 23(1)(c) of the U.S.–U.K. Income Tax Treaty, a U.S. corporation is entitled to continue to treat U.K. Advance Corporation Tax (ACT) as a creditable tax paid by a U.K. subsidiary in computing the allowable credit for foreign taxes deemed paid under section 902(a) of the Internal Revenue Code for the year in which the ACT was paid, when the subsidiary subsequently surrenders all or part of the ACT to lower-tier U.K. subsidiaries for use to satisfy their U.K. corporate tax liabilities.

⁵Nonacquiescence relating to whether the Service was entitled to assess and collect statutory interest on the amount of tax and additions to tax embodied in a Tax Court decision that resulted from a settlement agreement entered into by the taxpayers and the Service.

⁶Continued nonacquiescence, but that this action on decision be substituted for the action on decision reported at *Risman v. Commissioner*, AOD CC–1996–003 (March 4, 1996), relating to whether a remittance forwarded to the Service with a Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return*, constitutes a payment of tax or a deposit in the nature of a cash bond for purposes of the period of limitations for seeking a refund of such remittance.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274-5T: Substantiation requirements (temporary).

T.D. 8715

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

Substantiation of business expenses for travel, entertainment, gifts and listed property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains amendments to temporary regulations relating to the requirement that business expenses for travel, entertainment, gifts, or listed property be substantiated by documentary evidence (such as a receipt). The regulations affect persons making or receiving reimbursements for travel, entertainment, gifts, or listed property. The text of these temporary regulations also serves as the text of REG-209785-95, page 46.

DATES: These temporary regulations are effective March 25, 1997. Applicability: These temporary regulations are applicable to expenses paid or incurred after September 30, 1995.

FOR FURTHER INFORMATION CONTACT: Donna M. Crisalli at (202) 622-4920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public comment pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under

control number 1545-0771. Responses to this collection of information are required for a taxpayer to deduct certain business expenses or to substantiate certain reimbursements of business expenses.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing the burden, please refer to the preamble in the cross-reference notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

Receipt threshold

Section 274(d) disallows a trade or business deduction under section 162 for any traveling (including meals and lodging), entertainment, gift, or listed property expense, unless the taxpayer substantiates the elements of the expense by adequate records or by sufficient evidence. Under § 1.274-5T(c) of the temporary Income Tax Regulations, a taxpayer must maintain two types of records to satisfy the “adequate records” requirement: (1) a summary of expenses (account book, diary, log, statement of expense, trip sheets, or other similar record), sometimes called an expense account or expense voucher, and (2) documentary evidence (such as receipts or paid bills). Together, these records must establish the elements of amount, time, place, and business purpose (and for gifts and entertainment, business relationship of recipient or persons entertained) for each expenditure or use.

Section 1.274-5T(c)(2)(iii) generally requires that a taxpayer have a receipt or other documentary evidence to substantiate (A) any expenditure for lodging and (B) any other expenditure of \$25 or more. In Notice 95-50 (1995-2 C.B.

333), the IRS announced that it would raise the receipt threshold of § 1.274-5T(c)(2)(iii)(B) from \$25 to \$75, effective for expenses incurred on or after October 1, 1995. The temporary regulations effect this amendment by changing “\$25” in § 1.274-5T(c)(2)(iii)(B) to “\$75.” This change is applicable to both deductions and reimbursement arrangements and is expected to reduce the recordkeeping burden on affected taxpayers, including individuals and small businesses.

Definition of an “adequate accounting” to the employer

An employee who is reimbursed under a reimbursement or other expense allowance arrangement for expenses covered by section 274(d) must make an “adequate accounting” to the employer for the reimbursed expenses. Section 1.274-5T(f)(4) specifies that, as part of an adequate accounting, the employee must submit substantiation to the employer that satisfies the requirements of § 1.274-5T(c). Notice 95-50 also solicited comments on whether changes should be made to the substantiation requirements of the adequate accounting rules in § 1.274-5T. Comments received related primarily to the adequate accounting rules and the substantiation requirements in general.

1. Submission and retention of documentary evidence

A number of commentators, particularly federal government agencies, complained of the administrative burden and cost of storing large quantities of paper receipts. Some comments proposed that the employer should be allowed to dispose of the documentary evidence after an employee has made an adequate accounting, or return the documentary evidence to the employee for retention. Other comments suggested that submission by an employee of an expense voucher alone, without documentary evidence, should be considered an adequate accounting.

With the increase in the receipt threshold to \$75, and the use of electronic document transmission and retention (discussed below), the necessity for storing large quantities of paper records is significantly reduced. Nonetheless, the temporary regulations respond to the concerns expressed by these comments by amending § 1.274-5T(f)(4) to authorize the Commissioner to prescribe rules

modifying the substantiation requirements for an adequate accounting by an employee to an employer. Under the amendment, the Commissioner could publish rules defining the circumstances (including the use of specified internal controls) under which an employee may make an adequate accounting to his employer by submitting an expense account alone, without the necessity of submitting documentary evidence (such as receipts). This change is expected to reduce the recordkeeping burden for employers and employees. These rules would not change the substantiation requirements of § 1.274-5T(c) for deductions.

2. Maintenance of adequate records in electronic form

Some commentators suggested that taxpayers should be permitted to obtain and maintain records substantiating expenses under section 274(d) in electronic form. The temporary regulations make no change to the current regulations, which do not require that the records be in paper form. Rev. Proc. 91-59 (1991-2 C.B. 841), provides procedures for maintaining tax records in electronic form. Section 3.08 of Rev. Proc. 91-59 states that the procedures apply to documentation required by section 274(d).

3. Types of records that constitute acceptable documentary evidence

Some commentators suggested that credit card charge records should be considered acceptable documentary evidence of travel expenses, including lodging. They noted, however, that § 1.274-5T(c)(2)(iii) requires that documentary evidence of lodging must show separate amounts for charges such as lodging, meals, and telephone calls. A credit card statement or record of charge, unlike a hotel bill, normally will not segregate lodging and other expenses, such as meals and entertainment subject to the section 274(n) partial deduction disallowance, or personal expenses (such as personal phone calls or gift purchases) that may not be deducted. Therefore, such a credit card statement or record of charge alone will not constitute acceptable documentary evidence of a lodging expense.

The commentators proposed addressing this problem by using statistical sampling, conducted either by the IRS or by taxpayers, to establish a breakdown of expenses on hotel bills. One comment suggested that sampling could

form a basis for a “safe harbor” percentage or percentages (e.g., by industry or size of company) of hotel bills that would be deemed to represent the various types of possible expenses. Another comment suggested that the IRS adopt a mechanical test based on statistical sampling to make a reasonable allocation of the total hotel charge to meals.

The temporary regulations make no change to the current documentary evidence requirements for lodging expenses. Because of the large number of expenses that can be charged to hotel bills, and extensive variation from traveler to traveler in the types of expenses charged to hotel bills, any attempt to establish percentages for allocating hotel bills to lodging and other fully deductible business expenses, meals and entertainment, and personal expenses is considered impracticable.

A comment requested that the IRS clarify whether statements provided to travelers by airlines in lieu of tickets can constitute documentary evidence of travel. The current regulations are sufficiently flexible to permit use of a variety of forms of documentary evidence.

Other Comments in Response to Notice 95-50

1. Substantiation of business purpose

A commentator suggested that the regulations be revised to permit an employee to initially substantiate business purpose to the employer orally, for later entry into the expense processing system. The current regulations do not preclude an initial oral substantiation of business purpose which is reduced to writing no later than the time of the employee's final accounting to the employer.

2. Post-expenditure verification procedures

A comment suggested that the regulations be revised to permit an employer to conduct a post-expenditure review of only a statistical sampling, as opposed to 100%, of expense vouchers.

Section 1.274-5T(f)(5)(iii) states that an employee who makes an adequate accounting to his employer will not again be required to substantiate such expenses, unless the employer's accounting procedures are not adequate or it cannot be determined that such procedures are adequate. The district director will determine whether the employer's accounting procedures are adequate by considering all the facts and circum-

stances, including the employer's use of internal controls. The employer's accounting procedures should include a requirement that an expense account be verified and approved by a reasonable person other than the person incurring the expense. To the extent the employer fails to maintain adequate accounting procedures, the district director may require the employee to separately substantiate his expense account information.

Section 1.274-5T(f)(5)(iii) cites post-expenditure review of employees' expense accounts as an internal control that should normally be employed. However, whether the employer's post-expenditure review procedures are appropriate is a matter within the discretion of the district director, based on a review of all the facts and circumstances.

3. De minimis exception to substantiation requirements

A comment proposed that employees receiving \$1000 or less per year in reimbursed expenses be exempted from the requirement to substantiate the elements of the expenses, other than business purpose, to the employer. In view of the other changes made by the temporary regulations that will lessen a taxpayer's recordkeeping burden, such as the increase in the receipt threshold, the temporary regulations do not incorporate this suggestion.

4. Department of Labor substantiation requirements for plan trustees

A comment requested the IRS to coordinate with the Department of Labor to establish common substantiation requirements under ERISA for travel by multi-employer plan trustees. Modifications to conform the substantiation requirements under ERISA to those provided in the temporary regulations are outside the scope of the section 274(d) regulations.

5. Increase in limit on deduction for gifts

A comment requested that the \$25 limit on the deduction for gifts contained in section 274(b) be increased to \$75. The IRS has no discretion to raise this statutory limit.

6. Use of full federal per diem method to substantiate travel for deduction purposes

A comment suggested that self-employed individuals and unreimbursed

employees should be entitled to substantiate lodging expenses for deduction purposes by means of the "high-low" per diem method. Rev. Proc. 96-64 (1996-53 I.R.B. 52), permits this substantiation method for employee reimbursements only. This suggestion is outside the scope of this revision to the temporary regulations.

Special Analyses

It has been determined that these temporary regulations are not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that, by increasing the receipt threshold from \$25 to \$75, these regulations reduce the existing recordkeeping requirements of taxpayers, including small entities. The regulations do not otherwise significantly alter the reporting or recordkeeping duties of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Donna M. Crisalli, Office of the Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

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 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.274-5T also issued under 26 U.S.C. 274(d). * * *

Par. 2. An undesignated centerheading is added immediately following § 1.280H-1T to read as follows:

Taxable Years Beginning Prior to January 1, 1986

§ 1.274-5 redesignated as § 1.274-5A

Par. 3. Section 1.274-5 is redesignated as § 1.274-5A and added immediately following the undesignated centerheading "Taxable Years Beginning Prior to January 1, 1986".

Par. 4. Section 1.274-5T is amended by:

1. Revising the first sentence of paragraph (c)(2)(iii)(B).
2. Redesignating the text of paragraph (f)(4) as paragraph (f)(4)(i).
3. Adding a paragraph heading for paragraph (f)(4)(i).
4. Adding paragraphs (f)(4)(ii) and (f)(4)(iii).

The revisions and additions read as follows:

§ 1.274-5T Substantiation requirements (temporary).

* * * * *

- (c) * * *
- (2) * * *
- (iii) * * *

(B) Any other expenditure of \$75 or more (\$25 or more for expenditures incurred before October 1, 1995) except, for transportation charges, documentary evidence will not be required if not readily available, provided, however, that the Commissioner, in his discretion, may prescribe rules waiving such requirements in circumstances where he determines it is impracticable for such documentary evidence to be required. * * *

* * * * *

- (f) * * *
- (4) * * * (i) *In general.* * * *

(ii) *Procedures for adequate accounting without documentary evidence.* The Commissioner may, in his discretion, prescribe rules under which an employee may make an adequate accounting to his employer by submitting an account book, log, diary, etc., alone, without submitting documentary evidence.

(iii) *Employer.* For purposes of this section, the term *employer* includes an agent of the employer or a third party payor who pays amounts to an employee under a reimbursement or other expense allowance arrangement.

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. In § 602.101, paragraph (c) is amended by:

1. Removing the following entry from the table:

CFR part or section where identified and described	Current OMB control No.
* * *	* *
1.274-5	1545-0139 1545-0771
* * *	* *

2. Adding an entry in numerical order to the table to read as follows:

CFR part or section where identified and described	Current OMB control No.
* * *	* *
1.274-5A	1545-0139 1545-0771
* * *	* *

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved February 14, 1997.

Donald C. Lubick,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 24, 1997, 8:45 a.m., and published in the issue of the Federal Register for March 25, 1997, 62 F.R. 13988)

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted federal long-term rate is set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 501.—Exemption From Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Tax consequences of physician recruitment incentives provided by hospitals described in section 501(c)(3) of the Code. This ruling provides examples illustrating whether nonprofit hospitals that provide incentives to physicians to join their medical staffs or to provide medical services in the community violate the requirements for exemption as organizations described in section 501(c)(3) of the Code.

Rev. Rul. 97-21

ISSUE

Whether, under the facts described below, a hospital violates the requirements for exemption from federal income tax as an organization described in § 501(c)(3) of the Internal Revenue Code when it provides incentives to recruit private practice physicians to join its medical staff or to provide medical services in the community.

FACTS

All of the hospitals in the situations described below have been recognized as exempt from federal income tax under § 501(a) as organizations described in § 501(c)(3) and operate in accordance with the standards for exemption set forth in Revenue Ruling 69-545, 1969-2 C.B. 117. The physicians described in the following recruiting transactions do not have substantial influence over the affairs of the hospitals that are recruiting them. Therefore, they are not disqualified persons as defined in § 4958, nor do they have any personal or private interest in the activities of the organizations that would subject them to the inurement proscription of § 501(c)(3). Furthermore, in Situations 1, 2, and 4, the physicians have no pre-existing relationship with the hospital or the members of its board. For purposes of this revenue ruling, the physician recruiting activities described in Situations 1, 2, 3, and 4 are assumed to be lawful. However, because the Internal Revenue Service does not have jurisdiction regarding whether the activities described in Situations 1, 2, 3, and 4 are lawful under the Medicare and Medicaid anti-kickback statute, 42 U.S.C. § 1320a-7b(b), taxpayers may not rely upon the facts or assumptions described in this ruling for purposes relating to that statute.

Situation 1

Hospital A is located in County V, a rural area, and is the only hospital within a 100 mile radius. County V has been designated by the U.S. Public Health Service as a Health Professional Shortage Area for primary medical care professionals (a category that includes obstetricians and gynecologists). Physician M recently completed an ob/gyn residency and is not on Hospital A's medical staff. Hospital A recruits Physician M to establish and maintain a full-time private ob/gyn practice in its service area and become a member of its medical staff. Hospital A provides Physician M a recruitment incentive package pursuant to a written agreement negotiated at arm's-length. The agreement is in accordance with guidelines for physician recruitment that Hospital A's Board of Directors establishes, monitors, and reviews regularly to ensure that recruiting practices are consistent with Hospital A's exempt purposes. The agreement was approved by the committee appointed by Hospital A's

Board of Directors to approve contracts with hospital medical staff. Hospital A does not provide any recruiting incentives to Physician M other than those set forth in the written agreement.

In accordance with the agreement, Hospital A pays Physician M a signing bonus, Physician M's professional liability insurance premium for a limited period, provides office space in a building owned by Hospital A for a limited number of years at a below market rent (after which the rental will be at fair market value), and guarantees Physician M's mortgage on a residence in County V. Hospital A also lends Physician M practice start-up financial assistance pursuant to an agreement that is properly documented and bears reasonable terms.

Situation 2

Hospital B is located in an economically depressed inner-city area of City W. Hospital B has conducted a community needs assessment that indicates both a shortage of pediatricians in Hospital B's service area and difficulties Medicaid patients are having obtaining pediatric services. Physician N is a pediatrician currently practicing outside of Hospital B's service area and is not on Hospital B's medical staff. Hospital B recruits Physician N to relocate to City W, establish and maintain a full-time pediatric practice in Hospital B's service area, become a member of Hospital B's medical staff, and treat a reasonable number of Medicaid patients. Hospital B offers Physician N a recruitment incentive package pursuant to a written agreement negotiated at arm's-length and approved by Hospital B's Board of Directors. Hospital B does not provide any recruiting incentives to Physician N other than those set forth in the written agreement.

Under the agreement, Hospital B reimburses Physician N for moving expenses as defined in § 217(b), reimburses Physician N for professional liability "tail" coverage for Physician N's former practice, and guarantees Physician N's private practice income for a limited number of years. The private practice income guarantee, which is properly documented, provides that Hospital B will make up the difference to the extent Physician N practices full-time in its service area and the private practice does not generate a certain level of net income (after reasonable expenses of the practice). The amount guaranteed falls within the range reflected in re-

gional or national surveys regarding income earned by physicians in the same specialty.

Situation 3

Hospital C is located in an economically depressed inner city area of City X. Hospital C has conducted a community needs assessment that indicates indigent patients are having difficulty getting access to care because of a shortage of obstetricians in Hospital C's service area willing to treat Medicaid and charity care patients. Hospital C recruits Physician O, an obstetrician who is currently a member of Hospital C's medical staff, to provide these services and enters into a written agreement with Physician O. The agreement is in accordance with guidelines for physician recruitment that Hospital C's Board of Directors establishes, monitors, and reviews regularly to ensure that recruiting practices are consistent with Hospital C's exempt purpose. The agreement was approved by the officer designated by Hospital C's Board of Directors to enter into contracts with hospital medical staff. Hospital C does not provide any recruiting incentives to Physician O other than those set forth in the written agreement. Pursuant to the agreement, Hospital C agrees to reimburse Physician O for the cost of one year's professional liability insurance in return for an agreement by Physician O to treat a reasonable number of Medicaid and charity care patients for that year.

Situation 4

Hospital D is located in City Y, a medium to large size metropolitan area. Hospital D requires a minimum of four diagnostic radiologists to ensure adequate coverage and a high quality of care for its radiology department. Two of the four diagnostic radiologists currently providing coverage for Hospital D are relocating to other areas. Hospital D initiates a search for diagnostic radiologists and determines that one of the two most qualified candidates is Physician P.

Physician P currently is practicing in City Y as a member of the medical staff of Hospital E (which is also located in City Y). As a diagnostic radiologist, Physician P provides services for patients receiving care at Hospital E, but does not refer patients to Hospital E or any other hospital in City Y. Physician P is not on Hospital D's medical staff. Hospital D recruits Physician P to join its medical staff and to provide coverage

for its radiology department. Hospital D offers Physician P a recruitment incentive package pursuant to a written agreement, negotiated at arm's-length and approved by Hospital D's Board of Directors. Hospital D does not provide any recruiting incentives to Physician P other than those set forth in the written agreement.

Pursuant to the agreement, Hospital D guarantees Physician P's private practice income for the first few years that Physician P is a member of its medical staff and provides coverage for its radiology department. The private practice income guarantee, which is properly documented, provides that Hospital D will make up the difference to Physician P to the extent the private practice does not generate a certain level of net income (after reasonable expenses of the practice). The net income amount guaranteed falls within the range reflected in regional or national surveys regarding income earned by physicians in the same specialty.

Situation 5

Hospital F is located in City Z, a medium to large size metropolitan area. Because of its physician recruitment practices, Hospital F has been found guilty in a court of law of knowingly and willfully violating the Medicare and Medicaid anti-kickback statute, 42 U.S.C. § 1320a-7b(b), for providing recruitment incentives that constituted payments for referrals. The activities resulting in the violations were substantial.

LAW

Section 501(c)(3) provides, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable, scientific, or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See *Restatement (Second) of Trusts*, §§ 368, 372 (1959); 4A Austin W. Scott and William F. Fratcher, *The Law of Trusts* §§ 368, 372 (4th ed. 1989); and Rev. Rul. 69-545, 1969-2 C.B. 117. Under the common law of charitable trusts, all such organizations are subject to the

requirement that their purposes may not be illegal. See *Restatement (Second) of Trusts* § 377 (1959); 4A Austin W. Scott and William F. Fratcher, *The Law of Trusts* § 377 (4th ed. 1989); *Bob Jones University v. U.S.*, 461 U.S. 574, 591 (1983); Rev. Rul. 80-278, 1980-2 C.B. 175; Rev. Rul. 80-279, 1980-2 C.B. 176.

Section 1.501(c)(3)-1(c)(2) states that an organization is not operated exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)-1(c) defines "private shareholder or individual" as referring to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized exclusively for any of the purposes specified in § 501(c)(3) unless it serves public, rather than private interests. Thus, an organization applying for tax exemption under § 501(c)(3) must establish that it is not organized or operated for the benefit of private interests.

Rev. Rul. 69-545, 1969-2 C.B. 117, holds that a non-profit hospital that benefits a broad cross section of its community by having an open medical staff and a board of trustees broadly representative of the community, operating a full-time emergency room open to all regardless of ability to pay, and otherwise admitting all patients able to pay (either themselves, or through third party payers such as private health insurance or government programs such as Medicare) may qualify as an organization described in § 501(c)(3). The same standard has been used by the courts as the basis for evaluating whether health maintenance organizations qualify for exemption as organizations described in § 501(c)(3). See *Sound Health Association v. Commissioner*, 71 T.C. 158 (1978), acq. 1981-2 C.B. 2; *Geisinger Health Plan v. Commissioner*, 985 F.2d 1210 (3rd Cir. 1993), rev'g 62 T.C.M. (CCH) 1656 (1991).

Rev. Rul. 72-559, 1972-2 C.B. 247, holds that an organization that provides subsidies to recent law school graduates during the first three years of their practice to enable them to establish legal practices in economically depressed communities that have a shortage of available legal services and to provide free legal service to needy members of the community may qualify as an organization described in § 501(c)(3).

Rev. Rul. 73-313, 1973-2 C.B. 174, holds that attracting a physician to a community that had no available medical services furthered the charitable purpose of promoting the health of the community. In Rev. Rul. 73-313, residents of an isolated rural community had to travel a considerable distance to obtain care. Faced with the total lack of local services, the community formed an organization to raise funds and build a medical office building to attract a doctor to the locality. (No hospitals or existing medical practices were involved.) The ruling states that certain facts are particularly relevant: (1) the demonstrated need for a physician to avert a real and substantial threat to the community; (2) evidence that the lack of a suitable office had impeded efforts to attract a physician; (3) the arrangements were completely at arm's-length; and (4) there was no relationship between any person connected with the organization and the recruited physician. The ruling states that, under all the circumstances, the arrangement used to induce the doctor to locate a practice in the area "bear[s] a reasonable relationship to promotion and protection of the health of the community" and any private benefit to the physician is incidental to the public purpose achieved. It concludes that the activity furthers a charitable purpose and the organization qualifies for exemption as an organization described in § 501(c)(3).

Rev. Rul. 75-384, 1975-2 C.B. 204, holds that an organization whose primary activity is sponsoring antiwar protest demonstrations in which demonstrators are urged to commit violations of local ordinances and breaches of the public order does not qualify as an organization described in § 501(c)(3) because its activities demonstrate an illegal purpose that is inconsistent with charitable purposes.

Rev. Rul. 80-278, 1980-2 C.B. 175, and Rev. Rul. 80-279, 1980-2 C.B. 176, discuss the qualification as organizations described in § 501(c)(3) of organizations that conduct environmental litigation and environmental dispute mediation. In holding that these organizations may qualify, the rulings state that, in determining whether an organization meets the operational test, the issue is whether the particular activity undertaken by the organization appropriately furthers the organization's exempt purpose. The rulings state that an organization's activities will be considered permissible under § 501(c)(3) if the

following conditions are met: (1) the purpose of the organization is charitable; (2) the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions; and (3) the activities are in furtherance of the organization's exempt purpose and are reasonably related to the accomplishment of that purpose.

ANALYSIS

In order to meet the requirements of § 501(c)(3), a hospital that provides recruitment incentives to physicians must provide those incentives in a manner that does not cause the organization to violate the operational test of § 1.501(c)(3)-1. Whether the recruitment incentives cause the organization to violate the operational test is determined based on all relevant facts and circumstances. When a § 501(c)(3) hospital recruits a physician for its medical staff who is to perform services for or on behalf of the organization, the organization meets the operational test by showing that, taking into account all of the benefits provided the physician by the organization, the organization is paying reasonable compensation for the services the physician is providing in return. A somewhat different analysis must be applied when a § 501(c)(3) hospital recruits a physician for its medical staff to provide services to members of the surrounding community but not necessarily for or on behalf of the organization. In these cases, a violation will result from a failure to comply with any of the following four requirements:

First, the organization may not engage in substantial activities that do not further the hospital's exempt purposes or that do not bear a reasonable relationship to the accomplishment of those purposes. As discussed in Rev. Rul. 80-278 and Rev. Rul. 80-279, in determining whether an organization meets the operational test, the issue is whether the particular activity undertaken by the organization is appropriately in furtherance of the organization's exempt purpose.

Second, the organization must not engage in activities that result in inurement of the hospital's net earnings to a private shareholder or individual. An activity may result in inurement if it is structured as a device to distribute the net earnings of the hospital. See *Lorain*

Avenue Clinic v. Commissioner, 31 T.C. 141 (1958); *Birmingham Business College, Inc. v. Commissioner*, 276 F.2d 476 (5th Cir. 1960).

Third, the organization may not engage in substantial activities that cause the hospital to be operated for the benefit of a private interest rather than public interest so that it has a substantial non-exempt purpose. Section 1.501(c)(3)-1(d)(1)(ii).

Finally, the organization may not engage in substantial unlawful activities. As discussed in Rev. Rul. 75-384, Rev. Rul. 80-278, and Rev. Rul. 80-279, the conduct of an unlawful activity is inconsistent with charitable purposes. An organization conducts an activity that is unlawful, and therefore not in furtherance of a charitable purpose, if the organization's property is to be used for an objective that is in violation of the criminal law. Activities can accomplish an unlawful purpose through either direct or indirect means.

Situation 1

Like the organization described in Rev. Rul. 73-313, Hospital A has objective evidence demonstrating a need for obstetricians and gynecologists in its service area and has engaged in physician recruitment activity bearing a reasonable relationship to promoting and protecting the health of the community in accordance with Rev. Rul. 69-545. As with the subsidies provided to the recent law school graduates in Rev. Rul. 72-559, the payment of a bonus, the guarantee of a mortgage, the reimbursement of professional liability insurance and provision of subsidized office space for a limited time, and the lending of start-up financial assistance as recruitment incentives are reasonably related to causing Physician M to become a member of Hospital A's medical staff and to establish and maintain a full-time private ob/gyn practice in Hospital A's service area. The provision of the incentives under the circumstances described furthers the charitable purposes served by the hospital and is consistent with the requirements for exemption as an organization described in § 501(c)(3).

Situation 2

Like Hospital A in Situation 1, Hospital B has objective evidence demonstrating a need for pediatricians in its service area and has engaged in physician recruitment activity bearing a reasonable

relationship to promoting and protecting the health of the community in much the same manner as the organization described in Rev. Rul. 73-313. As with the recruitment incentive package provided by Hospital A, the payment of moving expenses, the reimbursement of professional liability "tail" coverage, and the provision of a reasonable private practice income guarantee as recruitment incentives are reasonably related to causing Physician N to become a member of Hospital B's medical staff and to establish and maintain a full-time private pediatric practice in Hospital B's service area. Thus, the recruitment activity described furthers the charitable purposes served by the hospital and is consistent with the requirements for exemption as an organization described in § 501(c)(3).

Situation 3

In accordance with the standards for exemption set forth in Rev. Rul. 69-545, Hospital C admits and treats Medicaid patients on a non-discriminatory basis. Hospital C has identified a shortage of obstetricians willing to treat Medicaid patients. The payment of Physician O's professional liability insurance premiums in return for Physician O's agreement to treat a reasonable number of Medicaid and charity care patients is reasonably related to the accomplishment of Hospital C's exempt purposes. Because the amount paid by Hospital C is reasonable and any private benefit to Physician O is outweighed by the public purpose served by the agreement, the recruitment activity described is consistent with the requirements for exemption as an organization described in § 501(c)(3).

Situation 4

Hospital D has objective evidence demonstrating a need for diagnostic radiologists to provide coverage for its radiology department so that it can promote the health of the community. The provision of a reasonable private practice income guarantee as a recruitment incentive that is conditioned upon Physician P obtaining medical staff privileges and providing coverage for the radiology department is reasonably related to the accomplishment of the charitable purposes served by the hospital. A significant fact in determining that the community benefit provided by the activity outweighs the private benefit provided to Physician P is the determi-

nation by the Board of Directors of Hospital D that it needs additional diagnostic radiologists to provide adequate coverage and to ensure a high quality of medical care. The recruitment activity described is consistent with the requirements for exemption as an organization described in § 501(c)(3).

Situation 5

Hospital F has engaged in physician recruiting practices resulting in a criminal conviction. As in Rev. Rul. 75-384, the recruiting activities were intentional and criminal, not isolated or inadvertent violations of a regulatory statute. An organization that engages in substantial unlawful activities, including activities involving the use of the organization's property for an objective that is in violation of criminal law, does not qualify as an organization described in § 501(c)(3). Because Hospital F has knowingly and willfully conducted substantial activities that are inconsistent with charitable purposes, it does not comply with the requirements of § 501(c)(3) and § 1.501(c)(3)-1.

HOLDING

The hospitals in Situations 1, 2, 3, and 4 have not violated the requirements for exemption from federal income tax as organizations described in § 501(c)(3) as a result of the physician recruitment incentive agreements they have made because the transactions further charitable purposes, do not result in inurement, do not result in the hospitals serving a private rather than a public purpose, and are assumed to be lawful for purposes of this revenue ruling.

Hospital F in Situation 5 does not qualify as an organization described in § 501(c)(3) because its unlawful physician recruitment activities are inconsistent with charitable purposes.

SCOPE

This ruling addresses only issues under § 501(c)(3) in the described situations. No inference is intended as to any other issue under any other provision of law, including any issue involving worker classification, income tax consequences to the physicians, and application of the Medicare and Medicaid anti-kickback statute, 42 U.S.C. § 1320a-7b(b).

DRAFTING INFORMATION

The principal author of this revenue ruling is Judith E. Kindell of the Exempt Organizations Division. For further information regarding this revenue ruling contact Judith E. Kindell on (202) 622-6494 (not a toll-free call).

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for May 1997.

Rev. Rul. 97-19

This revenue ruling provides various prescribed rates for federal income tax purposes for May 1997 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 97-19 TABLE 1
Applicable Federal Rates (AFR) for May 1997
Period for Compounding

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	6.23%	6.14%	6.09%	6.06%
110% AFR	6.86%	6.75%	6.69%	6.66%
120% AFR	7.51%	7.37%	7.30%	7.26%
130% AFR	8.14%	7.98%	7.90%	7.85%
<i>Mid-Term</i>				
AFR	6.85%	6.74%	6.68%	6.65%
110% AFR	7.55%	7.41%	7.34%	7.30%
120% AFR	8.25%	8.09%	8.01%	7.96%
130% AFR	8.95%	8.76%	8.67%	8.60%
150% AFR	10.37%	10.11%	9.99%	9.90%
175% AFR	12.15%	11.80%	11.63%	11.52%
<i>Long-Term</i>				
AFR	7.18%	7.06%	7.00%	6.96%
110% AFR	7.92%	7.77%	7.70%	7.65%
120% AFR	8.65%	8.47%	8.38%	8.32%
130% AFR	9.39%	9.18%	9.08%	9.01%

REV. RUL. 97-19 TABLE 2
Adjusted AFR for May 1997
Period for Compounding

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	3.97%	3.93%	3.91%	3.90%
Mid-term adjusted AFR	4.84%	4.78%	4.75%	4.73%
Long-term adjusted AFR	5.64%	5.56%	5.52%	5.50%

REV. RUL. 97-19 TABLE 3
Rates Under Section 382 for May 1997

Adjusted federal long-term rate for the current month	5.64%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.64%

REV. RUL. 97-19 TABLE 4
Appropriate Percentages Under Section 42(b)(2) for May 1997

Appropriate percentage for the 70% present value low-income housing credit	8.65%
Appropriate percentage for the 30% present value low-income housing credit	3.71%

REV. RUL. 97-19 TABLE 5

Rate Under Section 7520 for May 1997

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest

8.2%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1997. See Rev. Rul. 97-19, page 11.

Part II. Treaties and Tax Legislation

Subpart B.—Legislation and Related Committee Reports

Public Law 105-2
105th Congress, H.R. 668
February 28, 1997

An Act to amend the Internal Revenue Code of 1986 to reinstate the Airport and Airway Trust Fund excise taxes, and other purposes.

Airport and
Airway Trust
Fund Tax
Reinstatement
Act of 1997.
26 USC 1 note.
26 USC 1 *et seq.*

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE.

(a) SHORT TITLE.—This Act may be cited as the “Airport and Airway Trust Fund Tax Reinstatement Act of 1997”.

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

SEC. 2. REINSTATEMENT OF AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES.

(a) FUEL TAXES.—

(1) AVIATION FUEL.—Subparagraph (A) of section 4091(b)(3) is amended to read as follows:

“(A) The rate of tax specified in paragraph (1) shall be 4.3 cents per gallon—

“(i) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

“(ii) after September 30, 1997.”.

(2) AVIATION GASOLINE.—Subsection (d) of section 4081 is amended by striking the paragraph (3) added by section 1609(a) of the Small Business Job Protection Act of 1996 and by striking paragraphs (1) and (2) and inserting the following new paragraphs:

“(1) IN GENERAL.—The rates of tax specified in clauses (i) and (iii) of subsection (a)(2)(A) shall be 4.3 cents per gallon after September 30, 1999.

“(2) AVIATION GASOLINE.—The rate of tax specified in subsection (a)(2)(A)(ii) shall be 4.3 cents per gallon—

“(A) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

“(B) after September 30, 1997.”.

(3) NONCOMMERCIAL AVIATION.—Paragraph (3) of section 4041(c) is amended to read as follows:

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“(3) TERMINATION.—The rate of the taxes imposed by paragraph (1) shall be 4.3 cents per gallon—

“(A) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

“(B) after September 30, 1997.”.

(b) TICKET TAXES.—

(1) PERSONS.—Subsection (g) of section 4261 is amended to read as follows:

“(g) APPLICATION OF TAXES.—

“(1) IN GENERAL.—The taxes imposed by this section shall apply to—

“(A) transportation beginning during the period—

“(i) beginning on the 7th day after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

“(ii) ending on September 30, 1997, and

“(B) amounts paid during such period for transportation beginning after such period.

“(2) REFUNDS.—If, as of the date any transportation begins, the taxes imposed by this section would not have applied to such transportation if paid for on such date, any tax paid under paragraph (1)(B) with respect to such transportation shall be treated as an overpayment.”.

(2) PROPERTY.—Subsection (d) of section 4271 is amended to read as follows:

“(d) APPLICATION OF TAX.—

“(1) IN GENERAL.—The tax imposed by subsection (a) shall apply to—

“(A) transportation beginning during the period—

“(i) beginning on the 7th day after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

“(ii) ending on September 30, 1997, and

“(B) amounts paid during such period for transportation beginning after such period.

“(2) REFUNDS.—If, as of the date any transportation begins, the taxes imposed by this section would not have applied to such transportation if paid for on such date, any tax paid under paragraph (1)(B) with respect to such transportation shall be treated as an overpayment.”.

(c) TRANSFERS TO AIRPORT AND AIRWAY TRUST FUND.—

(1) IN GENERAL.—Subsection (b) of section 9502 is amended to read as follows:

“(b) TRANSFERS TO AIRPORT AND AIRWAY TRUST FUND.—There are hereby appropriated to the Airport and Airway Trust Fund amounts equivalent to—

Appropriation
authorization.

“(1) the taxes received in the Treasury under—

“(A) subsections (c) and (e) of section 4041 (relating to aviation fuels),

“(B) sections 4261 and 4271 (relating to transportation by air),

“(C) section 4081 (relating to gasoline) with respect to aviation gasoline (to the extent that the rate of the tax on such gasoline exceeds 4.3 cents per gallon), and

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“(D) section 4091 (relating to aviation fuel) to the extent attributable to the Airport and Airway Trust Fund financing rate, and

“(2) the amounts determined by the Secretary of the Treasury to be equivalent to the amounts of civil penalties collected under section 47107(n) of title 49, United States Code.”.

(2) TERMINATION OF FINANCING RATE.—Paragraph (3) of section 9502(f) is amended to read as follows:

“(3) TERMINATION.—Notwithstanding the preceding provisions of this subsection, the Airport and Airway Trust Fund financing rate shall be zero with respect to taxes imposed during any period that the rate of the tax imposed by section 4091(b)(1) is 4.3 cents per gallon.”.

(d) FLOOR STOCKS TAXES ON AVIATION GASOLINE AND AVIATION FUEL.—

(1) IMPOSITION OF TAX.—In the case of any aviation liquid on which tax was imposed under section 4081 or 4091 of the Internal Revenue Code of 1986 before the tax effective date and which is held on such date by any person, there is hereby imposed a floor stocks tax of—

(A) 15 cents per gallon in the case of aviation gasoline, and

(B) 17.5 cents per gallon in the case of aviation fuel.

(2) LIABILITY FOR TAX AND METHOD OF PAYMENT.—

(A) LIABILITY FOR TAX.—A person holding, on the tax effective date, any aviation liquid to which the tax imposed by paragraph (1) applies shall be liable for such tax.

(B) METHOD OF PAYMENT.—The tax imposed by paragraph (1) shall be paid in such manner as the Secretary shall prescribe.

(C) TIME FOR PAYMENT.—The tax imposed by paragraph (1) shall be paid on or before the first day of the 5th month beginning after the tax effective date.

(3) DEFINITIONS.—For purposes of this subsection—

(A) TAX EFFECTIVE DATE.—The term “tax effective date” means the date which is 7 days after the date of the enactment of this Act.

(B) AVIATION LIQUID.—The term “aviation liquid” means aviation gasoline and aviation fuel.

(C) AVIATION GASOLINE.—The term “aviation gasoline” has the meaning given such term in section 4081 of such Code.

(D) AVIATION FUEL.—The term “aviation fuel” has the meaning given such term by section 4093 of such Code.

(E) HELD BY A PERSON.—Aviation liquid shall be considered as “held by a person” if title thereto has passed to such person (whether or not delivery to the person has been made).

(F) SECRETARY.—The term “Secretary” means the Secretary of the Treasury or the Secretary’s delegate.

(4) EXCEPTION FOR EXEMPT USES.—The tax imposed by paragraph (1) shall not apply to—

(A) aviation liquid held by any person on the tax effective date exclusively for any use for which a credit or refund of the entire tax imposed by section 4081 or 4091 of such Code (as the case may be) is allowable for such

26 USC 4081
note.

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liquid purchased on or after such tax effective date for such use, or

(B) aviation fuel held by any person on the tax effective date exclusively for any use described in section 4092(b) of such Code.

(5) EXCEPTION FOR CERTAIN AMOUNTS OF FUEL.—

(A) IN GENERAL.—No tax shall be imposed by paragraph (1) on any aviation liquid held on the tax effective date by any person if the aggregate amount of such liquid (determined separately for aviation gasoline and aviation fuel) held by such person on such date does not exceed 2,000 gallons. The preceding sentence shall apply only if such person submits to the Secretary (at the time and in the manner required by the Secretary) such information as the Secretary shall require for purposes of this paragraph.

Applicability.

(B) EXEMPT FUEL.—Any liquid to which the tax imposed by paragraph (1) does not apply by reason of paragraph (4) shall not be taken into account under subparagraph (A).

(C) CONTROLLED GROUPS.—For purposes of this paragraph—

(i) CORPORATIONS.—

(I) IN GENERAL.—All persons treated as a controlled group shall be treated as 1 person.

(II) CONTROLLED GROUP.—The term “controlled group” has the meaning given such term by subsection (a) of section 1563 of such Code; except that for such purposes, the phrase “more than 50 percent” shall be substituted for the phrase “at least 80 percent” each place it appears in such subsection.

(ii) NONINCORPORATED PERSONS UNDER COMMON CONTROL.—Under regulations prescribed by the Secretary, principles similar to the principles of clause (i) shall apply to a group of persons under common control where 1 or more of such persons is not a corporation.

Regulations.
Applicability.

(6) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable with respect to the taxes imposed by section 4081 or 4091 of such Code shall, insofar as applicable and not inconsistent with the provisions of this subsection, apply with respect to the floor stocks taxes imposed by paragraph (1) to the same extent as if such taxes were imposed by such section 4081 or 4091, as the case may be.

(e) EFFECTIVE DATES.—

(1) FUEL TAXES.—The amendments made by subsection (a) shall apply to periods beginning on or after the 7th day after the date of the enactment of this Act.

26 USC 4041
note.

(2) TICKET TAXES.—

(A) IN GENERAL.—The amendments made by subsection (b) shall apply to transportation beginning on or after such 7th day.

26 USC 4261
note.

(B) EXCEPTION FOR CERTAIN PAYMENTS.—Except as provided in subparagraph (C), the amendments made by subsection (b) shall not apply to any amount paid before such 7th day.

PUBLIC LAW 105-2—FEB. 28, 1997

(C) PAYMENTS OF PROPERTY TRANSPORTATION TAX WITHIN CONTROLLED GROUP.—In the case of the tax imposed by section 4271 of the Internal Revenue Code of 1986, subparagraph (B) shall not apply to any amount paid by 1 member of a controlled group for transportation furnished by another member of such group. For purposes of the preceding sentence, all persons treated as a single employer under subsection (a) or (b) of section 52 of the Internal Revenue Code of 1986 shall be treated as members of a controlled group.

(f) APPLICATION OF LOOK-BACK SAFE HARBOR FOR DEPOSITS.—Nothing in the look-back safe harbor prescribed in Treasury Regulation section 40.6302(c)-1(c)(2) shall be construed to permit such safe harbor to be used with respect to any tax unless such tax was imposed throughout the look-back period.

Approved February 28, 1997.

AIRPORT AND AIRWAY TRUST FUND TAX REINSTATEMENT
 ACT OF 1997

FEBRUARY 13, 1997.—Committed to the Committee of the Whole House on the State
 of the Union and ordered to be printed

Mr. ARCHER, from the Committee on Ways and Means,
 submitted the following

REPORT

[To accompany H.R. 668]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 668) to amend the Internal Revenue Code of 1986 to reinstate the Airport and Airway Trust Fund excise taxes, and for other purposes, having considered the same, report favorably thereon without amendment, and recommend that the bill do pass.

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I. SUMMARY AND BACKGROUND

A. Summary

H.R. 668, as reported by the Committee on Ways and Means, provides for reinstatement of the excise taxes which fund the Airport and Airway Trust Fund (the "Airport Trust Fund") during the period beginning seven days after the date of enactment and ending after September 30, 1997. The bill further provides for transfer of all revenues derived from these taxes (including those deposited and currently scheduled to be deposited in the Treasury but which cannot be transferred under present law) to the Airport Trust Fund, and includes provisions to ensure prompt deposit of tax receipts with the Treasury once the excise taxes are reinstated.

B. Background and Need For Legislation

The operations and capital programs of the Federal Aviation Administration (the "FAA") are financed with appropriations from both the Airport Trust Fund and the General Fund. In general, capital programs are financed from the Airport Trust Fund and operational expenses (e.g., air traffic controllers) are financed from a mix of General Fund and Airport Trust Fund revenues. The Airport Trust Fund taxes were last imposed during the period from August 27, 1996, through December 31, 1996. Receipts from these taxes that were received in the Treasury Department before January 1, 1997, are authorized to be deposited in the Airport Trust Fund.

Recently, it was learned that the Treasury Department, which credits revenues to the Airport Trust Fund based on estimated receipts, has credited the Airport Trust Fund approximately \$1.2 billion of tax receipts from transportation sold during the months of September, October, and November, 1996, which has not as yet been received by the Treasury Department. The delay in receipts was caused by air carriers that (with Internal Revenue Service approval) delayed remitting taxes collected from their customers during this period until the air carriers file their quarterly excise tax returns for the fourth quarter of 1996 on February 28, 1997. The Treasury Department now must withdraw these amounts from the Airport Trust Fund.

As a result of this reduction in the Airport Trust Fund's balance, the uncommitted monies in the Airport Trust Fund will be sufficient only to fund the FAA's operating expenses through the end of the 1997 fiscal year, plus capital programs (at previously anticipated levels) through March 1997. Further, because this information reflects only the best available estimates and because of provisions of certain contracts for multiple phase projects, the FAA may be required to stop making new capital commitments and to begin providing notice that it intends to terminate other contracts by March 1, 1997, or earlier, absent legislative action.

By reinstating both the prior-law excise taxes and the authority to transfer tax revenues to the Airport Trust Fund, the bill will enable the FAA to avoid possible shut-down of its capital programs and to finance the agency's activities and programs at least through the end of the 1997 fiscal year.

C. Legislative History

Committee bill

H.R. 668 was introduced by Chairman Archer on February 11, 1997. The bill was considered in a Committee on Ways and Means markup on February 12, 1997, and was ordered favorably reported, without amendment, by voice vote.

Legislative hearing

The Committee on Ways and Means held a public hearing on February 5, 1997, on the solvency of the Airport Trust Fund and the impact of the recently discovered information regarding the delay in deposit of air transportation excise taxes on FAA operations and capital programs. The Committee received testimony from representatives of the Departments of the Treasury and Transportation.

II. EXPLANATION OF THE BILL

Prior and Present Law

Tax rates

Before January 1, 1997, excise taxes were imposed on commercial air passenger and freight transportation and on fuels used in general aviation (i.e., transportation on non-common carrier aircraft which is not for hire) to fund the Airport Trust Fund. The Airport Trust Fund was established in 1970 to finance a major portion of the costs of the Federal Aviation Administration (the "FAA") services and grant programs for State and local government airports. Before establishment of the Airport Trust Fund, Federal aviation expenditures were financed from general revenues; General Fund domestic air passenger and fuels taxes were imposed during this period. The structure of the Airport Trust Fund excise taxes has remained generally unchanged, except for rates, since 1970.

Before 1997, the Airport Trust Fund excise taxes included three taxes on commercial air transportation:

- (1) A 10-percent excise tax on domestic air passenger transportation;
- (2) A \$6 per person international air passenger departure tax; and
- (3) A 6.25-percent domestic air freight excise tax.

During the same period, general aviation (e.g., corporate aircraft) was subject to Airport Trust Fund excise taxes on the fuels it used rather than the commercial aviation passenger ticket and freight excise taxes. The Airport Trust Fund rates for these excise taxes were 17.5 cents per gallon for jet fuel and 15 cents per gallon for aviation gasoline.

Collection and deposit of tax

The air passenger ticket and freight excise taxes are collected from passengers and freight shippers by the commercial air carriers. The air carriers then remit the funds to the Treasury Department; however, the air carriers are not required to remit monies

immediately. Excise tax returns are filed quarterly (similar to annual income tax returns) with taxes being deposited on a semi-monthly basis (similar to estimated income taxes). For air transportation sold during a semi-monthly period, air carriers may elect to treat the taxes as collected on the last day of the first week of the second following semi-monthly period.¹ Under these "deemed collected" rules, for example, the taxes on air transportation sold between October 1 and October 15, are treated as collected by the air carriers on or before November 7. These amounts generally must be deposited with the Treasury by November 10. Thus, on average, revenues from commercial air passenger transportation generally are not received by the Federal Government until approximately one month after the air carrier actually sells the transportation.

Like income tax withholding and estimated tax payments, the excise taxes contain payment safe harbors for avoiding underpayment penalties. In general, Treasury Department regulations provide that commercial air carriers are not subject to underpayment penalties if their semi-monthly deposits of passenger ticket and freight waybill taxes for a quarter equal at least the amount of taxes they were required to remit during the second preceding calendar quarter (the "look back" rules). For example, air carriers generally would not be subject to underpayment penalties if their semi-monthly deposits for the fourth quarter (October 1 through December 31) equaled at least the amount they were required to remit during the second quarter (April 1 through June 30) of the same year.

In a general information letter to the Air Transport Association of America, dated August 30, 1996, the Internal Revenue Service advised the air carriers that, notwithstanding that no excise taxes were required to be remitted during a look back quarter, applicable Treasury Department regulations permitted the air carriers to continue to avail themselves of the safe harbor and avoid remitting taxes collected from consumers during September, October, and November of 1996 until the air carriers file their quarterly excise tax returns for that period on February 28, 1997. (Similarly, the air carriers are expected to retain most taxes collected from consumers during December 1996 until their excise tax returns for the first quarter of 1997 are due on May 31, 1997.)

On February 7, 1997, the Treasury Department announced that it will modify its regulations, effective for taxes imposed after February 10, 1997. (See, Treasury Notice 97-15, February 7, 1997.) The modified regulations will provide that the look-back safe harbor is not available for calculating deposits of taxes that were not in effect throughout the look-back quarter. Thus, a situation similar to that which arose with respect to air transportation taxes imposed in 1996 could not occur again because those taxes would not have been in effect throughout the second preceding calendar quarter. The Treasury Department notice does not change the deposit rules applicable to air transportation taxes imposed during the fourth quarter of 1996.

¹ Air carriers generally make this election because it allows them to delay remitting tax beyond the date when remittance otherwise would be required.

Trust Fund deposits

The Airport Trust Fund receives gross receipts attributable to the excise taxes described above. Present law provides that taxes received by the Treasury Department through the end of the period when the taxes were last imposed (i.e., through December 31, 1996) are deposited in the Airport Trust Fund. Taxes received after December 31, 1996, may not be transferred to the Airport Trust Fund under present law.

The Treasury Department credited the Airport Trust Fund with approximately \$1.2 billion based on incorrect estimates of excise tax deposits. Subsequently, the Treasury learned that the air carriers would not remit taxes imposed in September, October, and November of 1996 to the Treasury until February 28, 1997. The Treasury Department plans to reverse this error. As a result, the combination of the remaining uncommitted balance in the Airport Trust Fund and General Fund appropriations available to the FAA are believed to be sufficient only to support the FAA's operational expenses through the 1997 fiscal year and to allow new capital commitments (assuming previously anticipated commitment levels) to be made through March 1997. However, because best available estimates of the effect of this error on the FAA budget do not include any estimates of the costs of terminating certain multiple phase contracts, the FAA may have to stop making new commitments and begin notifying contractors of its intent to terminate multiple phase contracts on March 1, 1997, or earlier, absent legislative action.

Explanation of Provisions

Reinstate air transportation excise taxes

The bill reinstates the air transportation excise taxes that expired after December 31, 1996, during the period beginning seven days after the date of enactment and ending after September 30, 1997.

Transfer revenues to the Airport Trust Fund

The bill authorizes the Treasury Department to transfer to the Airport Trust Fund receipts attributable to excise taxes described above that are imposed on commercial and general aviation. This will permit transfer of receipts attributable to taxes imposed both during the period August 27, 1996, through December 31, 1996, and during the period beginning seven days after the date of enactment.

Modify Treasury Department tax deposit regulations

To prevent a delay in depositing tax similar to that which occurred with respect to the fourth quarter of 1996, the provisions of Treasury Department regulations providing an exception to penalties for underpayment of estimated excise taxes based on a look-back period will be made inapplicable when tax was not imposed throughout the look back period. In such a case, taxpayers could continue to use an alternative safe harbor that provides that no underpayment penalty is imposed as long as the taxpayer has paid at least 95 percent of the current quarter's liability. The Treasury

Department has recently announced that it will modify its regulations in this manner for taxes imposed after February 10, 1997.

Effective Date

The provisions reinstating the commercial air transportation excise taxes are effective for (1) transportation beginning during the period beginning seven days after the date of enactment and ending after September 30, 1997, and (2) amounts paid during such period for transportation beginning after September 30, 1997. If the air transportation excise taxes are not extended for transportation occurring after September 30, 1997, refunds would be provided for any taxes paid on passenger and freight transportation purchased before October 1, 1997, for transportation that occurs at a time when the taxes are not in effect. No tax is imposed on any payment made before seven days after the date of enactment (other than certain payments for freight transportation made between related parties), even if the transportation occurs during the period beginning seven days after the date of enactment and ending after September 30, 1997.

The provisions reinstating the general aviation gasoline excise tax are effective for gasoline removed during the period beginning seven days after the date of enactment and ending after September 30, 1997. The provision reinstating the general aviation jet fuel excise tax is effective for fuels sold by producers during the same period. Floor stocks taxes are imposed on these fuels held beyond the removal or producer level on the date which is seven days after the date of enactment.

The provisions relating to transfer of receipts to the Airport Trust Fund and the modification of the Treasury Department's excise tax deposit regulations are effective on the date of enactment. Consistent with Treasury Notice 97-15, described above, the modification to the Treasury Department's excise tax deposit regulations will not affect deposits of taxes imposed during the fourth quarter of 1996; those deposits will continue to be made under the Treasury Department regulations as in effect when liability for the taxes arose.

III. VOTE OF THE COMMITTEE

In compliance with clause 2(1)(2)(B) of rule XI of the Rules of the House of Representatives, the following statement is made concerning the vote on the motion to report the bill. The bill (H.R. 668) was ordered favorably reported, without amendment, by voice vote on February 12, 1997, with a quorum present.

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with clause 7(a) of Rule XIII of the rules of the House of Representatives, the following statement is made concerning the estimated budget effects of the bill as reported.

The bill, as reported, is estimated to increase net budget receipts by \$2.7 billion for fiscal years 1997 and 1998. (See the following revenue table.)

ESTIMATED BUDGET EFFECTS OF AN EXTENSION OF THE AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES THROUGH SEPTEMBER 30, 1997, FISCAL YEARS 1997-2007
 [in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997-02	1997-07
Extension of Airport and Airway Trust Fund excise taxes through 9/30/97 ...	tp7/data DOE	2,730	-- 54	.....	.....	.....	.....	.....	.....	.....	.....	.....	2,676	2,676

Note: Details may not add to totals due to rounding.
 Legend for "Effective" column: tp7/data DOE=tickets purchased 7 days after date of enactment for travel 7 days after date of enactment

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with subdivision (B) of clause 2(1)(3) of rule XI of the Rules of the House of Representatives, the Committee states that the provisions of the bill as reported involve no new or increased budget authority.

Tax expenditures

In compliance with subdivision (B) of clause 2(1)(3) of rule XI of the Rules of the House of Representatives, the Committee states that the provisions of the bill as reported involve no new or increased tax expenditures.

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with subdivision (C) of clause 2(1)(3) of rule XI of the Rules of the House of Representatives, requiring cost estimate prepared by the Congressional Budget Office, the Committee advises that the Congressional Budget Office has submitted the following statement on this bill.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, February 12, 1997.

Hon. BILL ARCHER,
*Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office and the Joint Committee on Taxation (JCT) have reviewed H.R. 668, the "Airport and Airway Trust Fund Tax Reinstatement Act of 1997," as ordered reported by the House Committee on Ways and Means on February 12, 1997. H.R. 668 would reinstate the Airport and Airway Trust Fund excise taxes through September 30, 1997. The JCT estimates that this bill would increase governmental receipts by \$2.730 billion in fiscal year 1997 and would decrease revenues by \$0.054 billion in fiscal year 1998. The revenue effects of the bill are summarized in the table below.

REVENUE EFFECTS OF THE AIRPORT AND AIRWAY TRUST FUND REINSTATEMENT ACT OF 1997
[By fiscal year, in billions of dollars]

	1997	1998	1999	2000	2001	2002-07
Proposed changes	2.730	-0.054	0.000	0.000	0.000	0.000

In accordance with the requirements of Public Law 104-4, the Unfunded Mandates Reform Act of 1995, JCT has determined that the bill contains an intergovernmental mandate. The provision to reinstate the Airport and Airway Trust Fund excise taxes through September 30, 1997, imposes a federal intergovernmental mandate because State, local, and tribal governments will be required to pay the requisite taxes for commercial air travel by their employees. JCT estimates that the direct costs of complying with this federal

intergovernmental mandate will not exceed \$50 million in any of the first five fiscal years.

In addition, JCT has determined that the bill contains a federal private sector mandate. The bill would impose direct costs on the private sector of more than \$100 million in fiscal year 1997. The JCT estimates the direct mandate cost of the tax increase in the bill would total no more than \$2,730 million in 1997, as shown below:

FEDERAL PRIVATE SECTOR MANDATES

(By fiscal year, in millions of dollars)

	1997	1998	1999	2000	2001
Direct cost of tax increase	2,730	- 54	0	0	0

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting receipts or direct spending through 1998. Because the bill would affect receipts, pay-as-you-go procedures would apply to the bill. These effects are summarized in the table below.

PAY-AS-YOU-GO CONSIDERATIONS

(By fiscal year, in millions of dollars)

	1997	1998
Changes in receipts	2,730	- 54
Changes in outlays	(1)	Not applicable

If you wish further details, please feel free to contact me or your staff may wish to contact Stephanie Weiner.

Sincerely,

JUNE E. O'NEILL, *Director.*

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to subdivision (A) of clause 2(1)(3) of rule XI of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was the result of the Committee's oversight activities concerning the status of the balance of the Airport Trust Fund and the need for expeditious reinstatement of the existing Airport Trust Fund excise taxes to provide adequate funding during fiscal year 1997 for the operations and capital programs of the FAA that the Committee concluded that it is appropriate to enact the provisions contained in the bill as reported.

The Committee on Ways and Means held a public hearing on this subject on February 5, 1997.

B. Summary of Findings and Recommendations of the Committee on Government Reform and Oversight

With respect to subdivision (D) of clause 2(1)(3) of rule XI of the Rules of the House of Representatives, the Committee advises that no oversight findings or recommendations have been submitted to

this Committee by the Committee on Government Reform and Oversight with respect to the provisions contained in the bill.

C. Constitutional Authority Statement

With respect to clause 2(l)(4) of rule XI of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 7 ("All bills for raising revenue shall originate in the House of Representatives") and Section 8 ("The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts * * * of the United States").

D. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104-4).

The Committee has determined that the provisions to extend the Airport and Airway Trust Fund excise taxes through September 30, 1997, impose a Federal mandate on the private sector and a Federal intergovernmental mandate. The costs required to comply with the Federal private sector mandate generally are no greater than the revenue estimate for the provisions. The provisions enable the FAA to avoid possible shutdown of its capital programs and to finance the agency's activities and programs at least through the end of the 1997 fiscal year. The Committee believes these benefits of the provisions are greater than the costs required to comply with the Federal mandates contained in the bill.

The provisions to reinstate the Airport and Airway Trust Fund taxes through September 30, 1997, impose a Federal intergovernmental mandate because State, local, and tribal governments will be required to pay the requisite excise taxes for commercial air travel by State, local, and tribal government employees. The staff of the Joint Committee on Taxation estimates that the direct costs of complying with this Federal intergovernmental mandate will not exceed \$50,000,000 in either the first fiscal year or in any one of the 4 fiscal years following the first fiscal year. The Committee intends that the Federal intergovernmental mandate be unfunded because the Airport and Airway Trust Fund excise taxes are intended to fund the maintenance of U.S. airports and airways and the Committee believes that it is appropriate for State, local, and tribal governments to continue to bear their allocable share of the responsibility for such funding.

The provisions reinstating the Airport and Airway Trust Fund excise taxes are imposed both on the private sector and on State, local, and tribal governments and, thus, do not affect the competitive balance between such governments and the private sector.

E. Applicability of House rule XXI5(c)

Rule XXI5(c) of the Rules of the House of Representatives provides, in part, that "No bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase shall be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members." The Committee has

carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increase within the meaning of the rule (as the bill only concerns reinstatement of prior-law Airport Trust Fund excise taxes and transfers of such tax revenues to the Airport Trust Fund).

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

* * * * *

Subtitle D—Miscellaneous Excise Taxes

* * * * *

CHAPTER 31—RETAIL EXCISE TAXES

* * * * *

Subchapter B—Special Fuels

* * * * *

SEC. 4041. IMPOSITION OF TAX.

(a) * * *

* * * * *

(c) **NONCOMMERCIAL AVIATION.—**

(1) * * *

* * * * *

[(3) **TERMINATION.**—The taxes imposed by paragraph (1) shall apply during the period beginning on September 1, 1982, and ending on December 31, 1995, and during the period beginning on the date which is 7 calendar days after the date of the enactment of the Small Business Job Protection Act of 1996 and ending on December 31, 1996. The termination under the preceding sentence shall not apply to so much of the tax imposed by paragraph (1) as does not exceed 4.3 cents per gallon.]

(3) *TERMINATION.*—*The rate of the taxes imposed by paragraph (1) shall be 4.3 cents per gallon—*

(A) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(B) after September 30, 1997.

* * * * *

CHAPTER 32—MANUFACTURERS EXCISE TAXES

* * * * *

Subchapter A—Automotive and Related Items

* * * * *

PART III—PETROLEUM PRODUCTS

* * * * *

Subpart A—Gasoline and Diesel Fuel

* * * * *

SEC. 4081. IMPOSITION OF TAX.

(a) * * *

* * * * *

(d) **TERMINATION.—**

[(1) **IN GENERAL.—**On and after October 1, 1999, the rates of tax specified in clauses (i) and (iii) of subsection (a)(2)(A) (other than the tax on aviation gasoline) shall be 4.3 cents per gallon.]

[(2) **AVIATION GASOLINE.—**On and after January 1, 1997, the rate specified in subsection (a)(2)(A)(ii) shall be 4.3 cents per gallon.]

(1) IN GENERAL.—The rates of tax specified in clauses (i) and (iii) of subsection (a)(2)(A) shall be 4.3 cents per gallon after September 30, 1999.

(2) AVIATION GASOLINE.—The rate of tax specified in subsection (a)(2)(A)(ii) shall be 4.3 cents per gallon—

(A) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(B) after September 30, 1997.

(3) **LEAKING UNDERGROUND STORAGE TANK TRUST FUND FINANCING RATE.—**The Leaking Underground Storage Tank Trust Fund financing rate under subsection (a)(2) shall not apply after December 31, 1995.

[(3) **AVIATION GASOLINE.—**After December 31, 1996, the rate of tax specified in subsection (a)(2)(A)(i) on aviation gasoline shall be 4.3 cents per gallon.]

* * * * *

Subpart B—Aviation Fuel

* * * * *

SEC. 4091. IMPOSITION OF TAX.

(a) * * *

(b) **RATE OF TAX.—**

(1) * * *

* * * * *

(3) **TERMINATION.—**

[(A) The rate of tax specified in paragraph (1) shall be 4.3 cents per gallon—

[(i) after December 31, 1995, and before the date which is 7 calendar days after the date of the enactment of the Small Business Job Protection Act of 1996, and

[(ii) after December 31, 1996.]

(A) *The rate of tax specified in paragraph (1) shall be 4.3 cents per gallon—*

(i) after December 31, 1996, and before the date which is 7 days after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(ii) after September 30, 1997.

* * * * *

CHAPTER 33—FACILITIES AND SERVICES

* * * * *

Subchapter C—Transportation By Air

* * * * *

PART I—PERSONS

* * * * *

SEC. 4261. IMPOSITION OF TAX.

(a) * * *

* * * * *

[(g) **TERMINATION.—**The taxes imposed by this section shall apply with respect to transportation beginning after August 31, 1982, and before January 1, 1996, and to transportation beginning on or after the date which is 7 calendar days after the date of the enactment of the Small Business Job Protection Act of 1996 and before January 1, 1997.]

(g) **APPLICATION OF TAXES.—**

(1) **IN GENERAL.—***The taxes imposed by this section shall apply to—*

(A) *transportation beginning during the period—*

(i) beginning on the 7th day after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and

(ii) ending on September 30, 1997, and

(B) amounts paid during such period for transportation beginning after such period.

(2) **REFUNDS.—***If, as of the date any transportation begins, the taxes imposed by this section would not have applied to such transportation if paid for on such date, any tax paid*

under paragraph (1)(B) with respect to such transportation shall be treated as an overpayment.

* * * * *

PART II—PROPERTY

* * * * *

SEC. 4271. IMPOSITION OF TAX.

(a) * * *

* * * * *

[(d) **TERMINATION.**—The tax imposed by subsection (a) shall apply with respect to transportation beginning after August 31, 1982, and before January 1, 1996, and to transportation beginning on or after the date which is 7 calendar days after the date of the enactment of the Small Business Job Protection Act of 1996 and before January 1, 1997.]

(d) **APPLICATION OF TAX.**—

(1) **IN GENERAL.**—*The tax imposed by subsection (a) shall apply to—*

(A) *transportation beginning during the period—*

(i) *beginning on the 7th day after the date of the enactment of the Airport and Airway Trust Fund Tax Reinstatement Act of 1997, and*

(ii) *ending on September 30, 1997, and*

(B) *amounts paid during such period for transportation beginning after such period.*

(2) **REFUNDS.**—*If, as of the date any transportation begins, the taxes imposed by this section would not have applied to such transportation if paid for on such date, any tax paid under paragraph (1)(B) with respect to such transportation shall be treated as an overpayment.*

* * * * *

Subtitle H—Financing of Presidential Election Campaigns

* * * * *

CHAPTER 98—TRUST FUND CODE

* * * * *

Subchapter A—Establishment of Trust Funds

* * * * *

SEC. 9502. AIRPORT AND AIRWAY TRUST FUND.

(a) * * *

[(b) **TRANSFER TO AIRPORT AND AIRWAY TRUST FUND OF AMOUNTS EQUIVALENT TO CERTAIN TAXES.**—There is hereby appropriated to the Airport and Airway Trust Fund—

[(1) amounts equivalent to the taxes received in the Treasury after August 31, 1982, and before January 1, 1997, under subsections (c) and (e) of section 4041 (taxes on aviation fuel) and under sections 4261 and 4271 (taxes on transportation by air);

[(2) amounts determined by the Secretary of the Treasury to be equivalent to the taxes received in the Treasury after August 31, 1982, and before January 1, 1997, under section 4081 (to the extent of 15 cents per gallon), with respect to gasoline used in aircraft;

[(3) amounts determined by the Secretary to be equivalent to the taxes received in the Treasury before January 1, 1997, under section 4091 (to the extent attributable to the Airport and Airway Trust Fund financing rate); and

[(4) amounts determined by the Secretary of the Treasury to be equivalent to the taxes received in the Treasury after August 31, 1982, and before January 1, 1997, under section 4071, with respect to tires of the types used on aircraft.]

(b) *TRANSFERS TO AIRPORT AND AIRWAY TRUST FUND.*—*There are hereby appropriated to the Airport and Airway Trust Fund amounts equivalent to—*

(1) *the taxes received in the Treasury under—*

(A) *subsections (c) and (e) of section 4041 (relating to aviation fuels),*

(B) *sections 4261 and 4271 (relating to transportation by air),*

(C) *section 4081 (relating to gasoline) with respect to aviation gasoline (to the extent that the rate of the tax on such gasoline exceeds 4.3 cents per gallon), and*

(D) *section 4091 (relating to aviation fuel) to the extent attributable to the Airport and Airway Trust Fund financing rate, and*

(2) *the amounts determined by the Secretary of the Treasury to be equivalent to the amounts of civil penalties collected under section 47107(n) of title 49, United States Code.*

* * * * *

(f) **DEFINITION OF AIRPORT AND AIRWAY TRUST FUND FINANCING RATE.**—For purposes of this section—

(1) * * *

* * * * *

[(3) **TERMINATION.**—Notwithstanding the preceding provisions of this subsection, the Airport and Airway Trust Fund financing rate shall be zero with respect to—

[(A) taxes imposed after December 31, 1995, and before the date which is 7 calendar days after the date of the enactment of the Small Business Job Protection Act of 1996 and

[(B) taxes imposed after December 31, 1996.]

(3) *TERMINATION.*—*Notwithstanding the preceding provisions of this subsection, the Airport and Airway Trust Fund financing rate shall be zero with respect to taxes imposed*

during any period that the rate of the tax imposed by section 4091(b)(1) is 4.3 cents per gallon.

* * * * *

○

AIRPORT AND AIRWAY TRUST FUND TAX REINSTATEMENT
ACT OF 1997

FEBRUARY 5, 1997.—Ordered to be printed

Mr. ROTH, from the Committee on Finance,
submitted the following

REPORT

[To accompany S. 279]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance, to which was referred the bill (S. 279) to amend the Internal Revenue Code of 1986 to reinstate the Airport and Airway Trust Fund excise taxes, and for other purposes, having considered the same, reports favorably thereon without amendment, and recommends that the bill do pass.

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I. SUMMARY AND BACKGROUND

A. SUMMARY

S. 279, as reported by the Committee on Finance, provides for reinstatement of the excise taxes which fund the Airport and Airway Trust Fund (the "Airport Trust Fund") during the period beginning seven days after the date of enactment and ending after September 30, 1997. The bill further provides for transfer of all revenues derived from these taxes (including those deposited and currently scheduled to be deposited in the Treasury but which cannot be transferred under present law) to the Airport Trust Fund, and includes provisions to ensure prompt deposit of tax receipts with the Treasury once the excise taxes are reinstated.

B. BACKGROUND AND REASONS FOR LEGISLATION

The operations and capital programs of the Federal Aviation Administration (the "FAA") are financed with appropriations from both the Airport Trust Fund and the General Fund. In general, capital programs are financed from the Airport Trust Fund and operational expenses (e.g., air traffic controllers) are financed from a mix of General Fund and Airport Trust Fund revenues. The Airport Trust Fund taxes were last imposed during the period from August 27, 1996, through December 31, 1996. Receipts from these taxes that were received in the Treasury Department before January 1, 1997, are authorized to be deposited in the Airport Trust Fund.

Recently, it was learned that the Treasury Department, which credits revenues to the Airport Trust Fund based on estimated receipts, has credited the Airport Trust Fund approximately \$1.2 billion of tax receipts from transportation sold during the months September, October, and November, 1996, which has not as yet been received by the Treasury Department. The delay in receipts was caused by air carriers that (with Internal Revenue Service approval) delayed remitting taxes collected from their customers during this period until the air carriers file their quarterly excise tax returns for the fourth quarter of 1996 on February 28, 1997. The Treasury Department now must withdraw these amounts from the Airport Trust Fund.

As a result of this reduction in the Airport Trust Fund's balance, the uncommitted monies in the Trust Fund will be sufficient only to fund the FAA's operating expenses through the end of the 1997 fiscal year, plus capital programs (at previously anticipated levels) through March 1997. Further, because this information reflects only the best available estimates and because of provisions of certain contracts for multiple phase projects, the FAA may be required to stop making new capital commitments and to begin providing notice that it intends to terminate other contracts by March 1, 1997, or earlier, absent legislative action.

By reinstating both the prior-law excise taxes and the authority to transfer tax revenues to the Airport Trust Fund, the bill will enable the FAA to avoid possible shut-down of its capital programs and to finance the agency's activities and programs at least through the end of the 1997 fiscal year.

C. LEGISLATIVE HISTORY

COMMITTEE BILL

S. 279 was introduced by Senators Roth and Moynihan on February 5, 1997. The bill was considered in a Committee on Finance markup on February 5, 1997, and was ordered favorably reported by unanimous voice vote.

LEGISLATIVE HEARING

The Committee on Finance held a public hearing on February 4, 1997, on the effects on the FAA budget of the expired air transportation excise taxes and of the recently discovered information regarding the deposit of such taxes collected by the air carriers from consumers during the months of September, October, and November 1996. The hearing also received testimony on the issue of possible restructuring of aviation excise taxes.

II. EXPLANATION OF THE BILL

PRIOR AND PRESENT LAW

TAX RATES

Before January 1, 1997, excise taxes were imposed on commercial air passenger and freight transportation and on fuels used in general aviation (i.e., transportation on non-common carrier aircraft which is not for hire) to fund the Airport Trust Fund. The Airport Trust Fund was established in 1970 to finance a major portion of the costs of the Federal Aviation Administration (the "FAA") services and grant programs for State and local government airports. Before establishment of the Airport Trust Fund, Federal aviation expenditures were financed from general revenues; General Fund domestic air passenger and fuels taxes were imposed during this period. The structure of the Airport Trust Fund excise taxes has remained generally unchanged, except for rates, since 1970.

Before 1997, the Airport Trust Fund excise taxes included three taxes on commercial air transportation:

- (1) A 10-percent excise tax on domestic air passenger transportation;
- (2) A \$6 per person international air passenger departure tax; and
- (3) A 6.25-percent domestic air freight excise tax.

During the same period, general aviation (e.g., corporate aircraft) was subject to Airport Trust Fund excise taxes on the fuels it used rather than the commercial aviation passenger ticket and freight excise taxes. The Airport Trust Fund rates for these excise taxes were 17.5 cents per gallon for jet fuel and 15 cents per gallon for aviation gasoline.

COLLECTION AND DEPOSIT OF TAX

The air passenger ticket and freight excise taxes are collected from passengers and freight shippers by the commercial air carriers. The air carriers then remit the funds to the Treasury Department; however, the air carriers are not required to remit monies

immediately. Excise tax returns are filed quarterly (similar to annual income tax returns) with taxes being deposited on a semi-monthly basis (similar to estimated income taxes). For air transportation sold during a semi-monthly period, air carriers may elect to treat the taxes as collected on the last day of the first week of the second following semi-monthly period.¹ Under these "deemed collected" rules, for example, the taxes on air transportation sold between October 1 and October 15, are treated as collected by the air carriers on or before November 7. These amounts generally must be deposited with the Treasury by November 10. Thus, on average, revenues from commercial air passenger transportation generally are not received by the Federal Government until approximately one month after the air carrier actually sells the transportation.

Like income tax withholding and estimated tax payments, the excise taxes contain payment safe harbors for avoiding underpayment penalties. In general, Treasury Department regulations provide that commercial air carriers are not subject to underpayment penalties if their semi-monthly deposits of passenger ticket and freight waybill taxes for a quarter equal at least the amount of taxes they were required to remit during the second preceding calendar quarter (the "look back" rules). For example, air carriers generally would not be subject to underpayment penalties if their semi-monthly deposits for the fourth quarter (October 1 through December 31) equaled at least the amount they were required to remit during the second quarter (April 1 through June 30) of the same year.

In a general information letter to the Air Transport Association of America, dated August 30, 1996, the Internal Revenue Service advised the air carriers that, notwithstanding that no excise taxes were required to be remitted during a look back quarter, applicable Treasury Department regulations permitted the air carriers to continue to avail themselves of the safe harbor and avoid remitting taxes collected from consumers during September, October, and November of 1996 until the air carriers file their quarterly excise tax returns for that period on February 28, 1997. (Similarly, the air carriers are expected to retain most taxes collected from consumers during December 1996 until their excise tax returns for the first quarter of 1997 are due on May 31, 1997.)

TRUST FUND DEPOSITS

The Airport Trust Fund receives gross receipts attributable to the excise taxes described above. Present law provides that taxes received by the Treasury Department through the end of the period when the taxes were last imposed (i.e., through December 31, 1996) are deposited in the Airport Trust Fund. Taxes received after December 31, 1996, may not be transferred to the Airport Trust Fund under present law.

The Treasury Department credited the Airport Trust Fund with approximately \$1.2 billion based on incorrect estimates of excise tax deposits. Subsequently, the Treasury learned that the air car-

¹ Air carriers generally make this election because it allows them to delay remitting tax beyond the date when remittance otherwise would be required.

riers would not remit taxes attributable to the fourth quarter of 1996 to the Treasury until February 28, 1997. The Treasury Department plans to reverse this error. As a result, the combination of the remaining uncommitted balance in the Airport Trust Fund and General Fund appropriations available to the FAA are believed to be sufficient only to support the FAA's operational expenses through the 1997 fiscal year and to allow new capital commitments (assuming previously anticipated commitment levels) to be made through March 1997. However, because best available estimates of the effect of this error on the FAA budget do not include any estimates of the costs of terminating certain multiple phase contracts, the FAA may have to stop making new commitments and begin notifying contractors of its intent to terminate multiple phase contracts on March 1, 1997, or earlier, absent legislative action.

EXPLANATION OF PROVISIONS

REINSTATE AIR TRANSPORTATION EXCISE TAXES

The bill reinstates the air transportation excise taxes that expired after December 31, 1996, during the period beginning seven days after the date of enactment and ending after September 30, 1997.

TRANSFER REVENUES TO THE AIRPORT TRUST FUND

The bill authorizes the Treasury Department to transfer to the Airport Trust Fund receipts attributable to excise taxes described above that are imposed on commercial and general aviation. This will permit transfer of receipts attributable to taxes imposed both during the period August 27, 1996, through December 31, 1996, and during the period beginning seven days after the date of enactment.

MODIFY TREASURY DEPARTMENT TAX DEPOSIT REGULATIONS

To prevent a delay in depositing tax similar to that which occurred with respect to the fourth quarter of 1996, the provisions of Treasury Department regulations providing an exception to penalties for underpayment of estimated excise taxes based on a look-back period will be made inapplicable when tax was not imposed throughout the look-back period. In such a case, taxpayers could continue to use a present alternative safe harbor that provides that no underpayment penalty is imposed as long as the taxpayer has paid at least 95 percent of the current quarter's liability.

EFFECTIVE DATE

The provisions reinstating the commercial air transportation excise taxes are effective for (1) transportation beginning during the period beginning seven days after the date of enactment and ending after September 30, 1997, and (2) amounts paid during such period for transportation beginning after September 30, 1997. If the air transportation excise taxes are not extended for transportation occurring after September 30, 1997, refunds would be provided for any taxes paid on passenger and freight transportation purchased before October 1, 1997, for transportation that occurs at

a time when the taxes are not in effect. No tax is imposed on any payment made before seven days after the date of enactment (other than certain payments for freight transportation made between related parties), even if the transportation occurs during the period beginning seven days after the date of enactment and ending after September 30, 1997.

The provisions reinstating the general aviation gasoline excise tax are effective for gasoline removed during the period beginning seven days after the date of enactment and ending after September 30, 1997. The provision reinstating the general aviation jet fuel excise tax is effective for fuels sold by producers during the same period. Floor stocks taxes are imposed on these fuels held beyond the removal or producer level on the date which is seven days after the date of enactment.

The provisions relating to transfer of receipts to the Airport Trust Fund and the modification of the Treasury Department's excise tax deposit regulations are effective on the date of enactment.

For any transportation beginning before the date of enactment, present law continues to apply.

III. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATES

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the bill as reported.

The bill, as reported, is estimated to increase net budget receipts by \$2.7 billion for fiscal years 1997 and 1998. (See the following revenues table.)

Estimated Budget Effects of an Extension of the Airport and Airway Trust Fund Excise Taxes Through Sept. 30, 1997; Effective tp7data DOE¹

(In millions of dollars; fiscal years 1997-2007)

1997	2,730
1998	- 54
1999	
2000	
2001	
2002	
2003	
2004	
2005	
2006	
2007	
1997-2002	2,676
1997-2007	2,676

¹ tp7data DOE=tickets purchased 7 days after date of enactment for travel 7 days after date of enactment.

Note.—Details may not add to totals due to rounding.

B. BUDGET AUTHORITY AND TAX EXPENDITURES

BUDGET AUTHORITY

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the provisions of the bill as reported involve no new or increased budget authority.

TAX EXPENDITURES

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the provisions of the bill as reported involve no new or increased tax expenditures.

C. CONSULTATION WITH CONGRESSIONAL BUDGET OFFICE

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has submitted the following statement on this bill:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, February 5, 1997.

Hon. WILLIAM V. ROTH, Jr.
*Chairman, Committee on Finance,
U.S. Senate, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office and the Joint Committee on Taxation (JCT) have reviewed the "Airport and Airway Trust Fund Reinstatement Act of 1997," as ordered reported by the Senate Committee on Finance on February 5, 1997. The bill would reinstate the Airport and Airway Trust Fund excise taxes through September 30, 1997. The JCT estimates that this bill would increase governmental receipts by \$2.730 billion in fiscal year 1997 and would decrease revenues by \$0.054 billion in fiscal year 1998. The revenue effects of the bill are summarized in the table below.

REVENUE EFFECTS OF THE AIRPORT AND AIRWAY TRUST FUND REINSTATEMENT ACT OF 1997
(By fiscal year, in billions of dollars)

	1997	1998	1999	2000	2001	2002-2007
Proposed changes	2.730	-0.054	0.000	0.000	0.000	0.000

In accordance with the requirements of Public Law 104-4, the Unfunded Mandates Reform Act of 1995, JCT has determined that the bill contains an intergovernmental mandate. The provision to reinstate the Airport and Airway Trust Fund excise taxes through September 30, 1997, imposes a federal intergovernmental mandate because State, local, and tribal governments will be required to pay the requisite taxes for commercial air travel by their employers. JCT estimates that the direct costs of complying with this federal intergovernmental mandate will not exceed \$50 million in any of the first five fiscal years.

In addition, JCT has determined that the bill contains a federal private sector mandate. The bill would impose direct costs on the private sector of more than \$100 million in fiscal year 1997. The JCT estimates the direct mandate cost of the tax increase in the bill would total \$2,730 million in 1997, as shown below:

FEDERAL PRIVATE SECTOR MANDATES

(By fiscal year, in millions of dollars)

	1997	1998	1999	2000	2001
Direct cost of tax increase	2,730	- 54	0	0	0

Please refer to the enclosed letter for a more detailed account of these mandates.

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting receipts or direct spending through 1998. Because the bill would affect receipts, pay-as-you-go procedures would apply to the bill. There effects are summarized in the table below.

PAY-AS-YOU-GO CONSIDERATIONS

(By fiscal year, in millions of dollars)

	1997	1998
Changes in receipts	2,730	- 54
Changes in outlays	Not Applicable	

If you wish further details, please feel free to contact me or your staff may wish to contact Stephanie Weiner.

Sincerely,

JUNE E. O'NEILL, *Director.*

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON TAXATION,
Washington, DC, February 5, 1997.

Mrs. JUNE O'NEILL,
*Director, Congressional Budget Office,
U.S. Congress, Washington, DC.*

DEAR MRS. O'NEILL: We have reviewed the provision approved by the Senate Finance Committee on February 5, 1997, to extend the Airport and Airway Trust Fund excise taxes through September 30, 1997. In accordance with the requirements of Public Law 104-4, the Unfunded Mandates Reform Act of 1995 (the "Unfunded Mandates Act"), we have determined that this provision contains Federal private sector and intergovernmental mandates. The attached revenue table reflects amounts that are no greater than the aggregate estimated amounts that the private sector will be required to spend in order to comply with the Federal private sector mandates imposed by the provision.

In addition, this provision imposes a Federal intergovernmental mandate because State, local, and tribal governments will be required to pay the requisite taxes for commercial air travel by State, local, and tribal government employees. The staff of the Joint Committee on Taxation estimates that the direct costs of complying with this Federal intergovernmental mandate will not exceed \$50,000,000 in either the first fiscal year or in any of the 4 fiscal years following the first fiscal year.

If you would like to discuss this matter in further detail, please feel free to contact me. Thank you for your cooperation in this matter.

Sincerely,

KENNETH J. KIES, *Chief of Staff.*

IV. VOTE OF THE COMMITTEE

In compliance with paragraph 7(b) of the Rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the vote of the motion to report the bill. The bill was ordered favorably reported, without amendment, by unanimous voice vote on February 5, 1997, with a quorum present.

One proposed amendment by Senator Graham to extend the Airport Trust Fund excise taxes through December 31, 1997 was defeated by voice vote.

V. REGULATORY IMPACT AND OTHER MATTERS

A. REGULATORY IMPACT

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the possible regulatory impact that might be incurred in carrying out the bill as reported.

IMPACT ON INDIVIDUALS AND BUSINESSES

The bill reinstates the Airport Trust Fund excise taxes that were in effect before January 1, 1997, for the period beginning seven days after the date of enactment through September 30, 1997. This will involve imposition and collection of the air passenger and air freight excise taxes by commercial air carriers as well as the timely remittance of the excise taxes to the Federal Government. Depending on whether these excise taxes are partially or fully passed on to consumers in the price, the consumers may or may not incur higher air fares during the tax extension period.

Likewise, the reimposition of the excise taxes on noncommercial aviation may or may not result in some price increase on non-commercial aviation users, depending on price competitive factors now and since the prior taxes expired on January 1, 1997.

IMPACT ON PERSONAL PRIVACY AND PAPERWORK

The bill as reported will have no impact on personal privacy. The reinstatement of the Airport Trust Fund excise taxes will result in the continuation of filing quarterly excise tax returns and semi-monthly deposits by commercial air carriers and by users of non-commercial aviation fuels.

B. INFORMATION RELATING TO UNFUNDED MANDATES

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104-4).

The Committee has determined that the provisions to extend the Airport and Airway Trust Fund excise taxes through September 30, 1997, impose a Federal mandate on the private sector and a Federal intergovernmental mandate. The costs required to comply with

the Federal private sector mandate generally are no greater than the revenue estimate for the provisions. The provisions enable the FAA to avoid possible shutdown of its capital programs and to finance the agency's activities and programs at least through the end of the 1997 fiscal year. The Committee believes these benefits of the provisions are greater than the costs required to comply with the Federal mandates contained in the bill.

The provisions to reinstate the Airport and Airway Trust Fund taxes through September 30, 1997, impose a Federal intergovernmental mandate because State, local, and tribal governments will be required to pay the requisite excise taxes for commercial air travel by State, local, and tribal government employees. The staff of the Joint Committee on Taxation estimates that the direct costs of complying with this Federal intergovernmental mandate will not exceed \$50,000,000 in either the first fiscal year or in any one of the 4 fiscal years following the first fiscal year. The Committee intends that the Federal intergovernmental mandate be unfunded because the Airport and Airway Trust Fund excise taxes are intended to fund the maintenance of U.S. airports and airways and the Committee believes that it is appropriate for State, local, and tribal governments to bear their allocable share of the responsibility for such funding.

The provisions reinstating the Airport and Airway Trust Fund excise taxes are imposed both on the private sector and on State, local, and tribal governments and, thus, do not affect the competitive balance between such governments and the private sector.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).

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Part III. Administrative, Procedural, and Miscellaneous

Credit for Producing Fuel From a Nonconventional Source, Section 29 Inflation Adjustment Factor, and Section 29 Reference Price

Notice 97-28

This notice publishes the § 29 inflation adjustment factor, the nonconventional source fuel credit, and the § 29 reference price for calendar year 1996. These are used to determine the credit allowable on fuel produced from a nonconventional source under § 29 of the Internal Revenue Code. The calendar year 1996 inflation-adjusted credit applies to the sales of barrel-of-oil equivalent of qualified fuels sold by a taxpayer to an unrelated person during the 1996 calendar year, the domestic production of which is attributable to the taxpayer.

BACKGROUND

Section 29(a) provides for a credit for producing fuel from a nonconventional source, measured in barrel-of-oil equivalent of qualified fuels, the production of which is attributable to the taxpayer and sold by the taxpayer to an unrelated person during the tax year. The credit is equal to the product of \$3.00 and the appropriate inflation adjustment factor.

Section 29(b)(1) and (2) provides for a phaseout of the credit. The credit allowable under § 29(a) must be reduced by an amount which bears the same ratio to the amount of the credit (determined without regard to § 29(b)(1)) as the amount by which the reference price for the calendar year in which the sale occurs exceeds \$23.50 bears to \$6.00. The \$3.00 in § 29(a) and the \$23.50 and \$6.00 must each be adjusted by multiplying these amounts by the 1996 inflation adjustment factor. In the case of gas from a tight formation, the \$3.00 amount in § 29(a) must not be adjusted.

Section 29(c)(1) defines the term “qualified fuels” to include oil produced from shale and tar sands; gas produced from geopressurized brine, Devonian shale, coal seams, or a tight formation, or biomass; and liquid, gaseous, or solid synthetic fuels produced from coal (including lignite), including such fuels when used as feedstocks.

Section 29(d)(1) provides that the credit is to be applied only for sale of qualified fuels the production of which is within the United States (within the meaning of § 638(1)) or a possession of the United States (within the meaning of § 638(2)).

Section 29(d)(2)(A) requires that the Secretary, not later than April 1 of each calendar year, determine and publish in the Federal Register the inflation adjustment factor and the reference price for the preceding calendar year.

Section 29(d)(2)(B) defines “inflation adjustment factor” for a calendar year as the fraction the numerator of which is the GNP implicit price deflator for the calendar year and the denominator of which is the GNP implicit price deflator for calendar year 1979. The term “GNP implicit price deflator” means the first version of the implicit price deflator for the gross national product as computed and published by the Department of Commerce.

Section 29(d)(2)(C) defines “reference price” to mean with respect to a calendar year the Secretary’s estimate of the annual average wellhead price per barrel of all domestic crude oil the price of which is not subject to regulation by the United States.

Section 29(d)(3) provides that in the case of a property or facility in which more than one person has an interest, except to the extent provided by regulations prepared by the Secretary, production from the property or facility (as the case may be) must be allocated among

the persons in proportion to their respective interests in the gross sales from the property or facility.

Section 29(d)(5) and (6) provides that the term “barrel-of-oil equivalent” with respect to any fuel generally means that amount of the fuel which has a Btu content of 5.8 million.

INFLATION ADJUSTMENT FACTOR AND REFERENCE PRICE

The inflation adjustment factor for calendar year 1996 is 1.9837. The reference price for calendar year 1996 is \$18.46. As required by § 29(d)(2)(A), the inflation adjustment factor and reference price for calendar year 1996 were published in the Federal Register on April 4, 1997 (62 Fed. Reg. 16216).

PHASE-OUT CALCULATION

Because the calendar year 1996 reference price does not exceed \$23.50 multiplied by the inflation adjustment factor, the phaseout of the credit provided for in § 29(b)(1) does not occur for any qualified fuel sold in calendar year 1996.

CREDIT AMOUNT

The nonconventional source fuel credit under § 29(a) is \$5.95 per barrel-of-oil equivalent of qualified fuels (\$3.00 x 1.9837). This amount was published in the Federal Register on April 4, 1997 (62 Fed. Reg. 16216).

DRAFTING INFORMATION CONTACT

The principal author of this notice is David G. McMunn of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Mr. McMunn on (202)622-3110 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Substantiation of Business Expenses for Travel, Entertainment, Gifts and Listed Property

REG-209785-95

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In T.D. 8715, page 5, the IRS is issuing temporary regulations relating to the substantiation requirements for business expenses for travel, entertainment, gifts, or listed property. The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronically generated comments and requests for a public hearing must be received by June 23, 1997.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG-209795-95), room 5228, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (REG-209785-95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC, or electronically, via the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, contact Donna M. Crisalli, (202) 622-4920; concerning submissions, contact Christina Vasquez, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treas-

ury, **Office of Information and Regulatory Affairs**, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by May 27, 1997.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this notice of proposed rulemaking is in § 1.274-5T(c)(2) and (f)(4). This information is required by the IRS as a condition for a taxpayer to deduct certain business expenses or exclude from income certain reimbursed business expenses of employees. This information will be used to determine whether a taxpayer properly qualifies for a deduction or exclusion. The collection of information is required in order to deduct certain business expenses or exclude from income certain reimbursed business expenses of employees. The likely respondents and recordkeepers are individuals, business or other for-profit institutions, state or local governments, federal agencies, and nonprofit institutions. Estimated total annual reporting and recordkeeping burden: 36,920,000 hours.

The estimated annual burden per respondent or recordkeeper varies from 10 minutes to 20 hours, depending on individual circumstances, with an estimated average of 1.3 hours.

Estimated number of respondents and recordkeepers: 28,400,000.

Estimated annual frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

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 is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that, by increasing the receipt threshold from \$25 to \$75, these regulations are expected to reduce the existing recordkeeping requirements of taxpayers, including small entities, from 49,375,000 hours to 36,920,000 hours. The regulations do not otherwise significantly alter the reporting or recordkeeping duties of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) 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 Requests for a Public Hearing

Before adopting these proposed regulations as final regulations, consideration will be given to any comments that are submitted timely (and in the manner described in ADDRESSES portion of this preamble) to the IRS. The IRS is considering publishing a revenue procedure implementing § 1.274-5T(f)(4)(ii) of the temporary regulations (that is, prescribing rules under which an employee may make an adequate accounting to his employer by submitting an expense voucher or equivalent without submitting documentary evidence such as receipts) for federal government

agencies that use the published procedures. In addition, the IRS is considering whether there are circumstances or conditions under which the IRS could extend these procedures beyond federal government agencies, and requests comments in this regard. The IRS also requests comments on what procedures (such as internal controls) should be required in any rules that permit a taxpayer to satisfy the substantiation requirements of section 274(d) for purposes of deducting business expenses reimbursed to employees who have accounted for their expenses only by means of an expense voucher or equivalent without documentary evidence such as receipts. All comments will be available for public inspection and copying. A public hearing will be scheduled and held upon written request by any person who submits written comments on the proposed rules. Notice of the time and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Donna M. Crisalli, Office of the Assistant Chief Counsel (Income Tax and Accounting). However, personnel from other offices of the IRS and Treasury Department participated in their development.

* * * * *

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 an entry to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.274-5 also issued under 26 U.S.C. 274(d). * * *

Par. 2. Section 1.274-5 is added to read as follows:

§ 1.274-5 Substantiation requirements.

(a) through (c)(2)(iii)(A) [Reserved]. For further guidance, see § 1.274-5T.

(c)(2)(iii)(B) [The text of paragraph (c)(2)(iii)(B) is the same as the text in § 1.274-5T published in T.D. 8715].

(c)(2)(iv) through (f)(3) [Reserved]. For further guidance, see § 1.274-5T.

(f)(4) through (f)(4)(iii) [The text of paragraphs (f)(4) through (f)(4)(iii) is the same as the text in T.D. 8715, page 5.

(f)(5) through (l) [Reserved]. For further guidance, see § 1.274-5T.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 24, 1997, 8:45 a.m., and published in the issue of the Federal Register for March 25, 1997, 62 F.R. 14051)

Notice of Proposed Rulemaking and Notice of Public Hearing

Guidance Regarding Charitable Remainder Trusts

REG-209823-96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed amendments to the regulations under section 664 of the Internal Revenue Code of 1986 relating to charitable remainder trusts and under section 2702 relating to special valuation rules for transfers of interests in trusts. The proposed amendments contain rules on the conditions under which the governing instrument may provide for a change in the method of calculating the unitrust amount, the date by which the annuity amount or the unitrust amount under the fixed percentage method must be paid to the recipient, who is required to value unmarketable assets, and when section 2702 applies to certain charitable remainder unitrusts. The proposed regulations clarify existing law that prohibits allocating pre-contribution capital gain to trust income. The proposed amendments also contain an example illustrating how the ordering rule of section 664(b) applies to distributions from a charitable remainder unitrust using an income exception method to calculate the unitrust amount. This document also provides notice of a public hearing on these proposed regulations.

DATES: Comments and outlines of topics to be discussed at the public hearing scheduled for September 9, 1997, at 10 a.m. must be received by August 19, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-209823-96),

room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-209823-96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Jeffrey A. Erickson or Mary Beth Collins, (202) 622-3070; concerning submissions and the hearing, Evangelista Lee, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by July 17, 1997. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through

the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in § 1.664-1(a)(7). This information is required to allow taxpayers alternative means of valuing a charitable remainder trust's hard-to-value assets. This information will be used to determine if a taxpayer properly claimed a charitable deduction for a contribution to a charitable remainder trust and if assets in the charitable remainder trust are properly valued each year. The collection of information is voluntary. The likely respondents are for-profit entities.

Estimated total annual recordkeeping burden: 75 hours.

Estimated average annual burden hours per respondent: .5 hours.

Estimated number of respondents: 150.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document proposes amendments to 26 CFR parts 1 and 25 to provide additional rules under sections 664 and 2702. Section 664, added to the Internal Revenue Code by section 201 of the Tax Reform Act of 1969 (Public Law 91-172), contains the rules for charitable remainder trusts. In general, a charitable remainder trust provides for a specified periodic distribution to one or more noncharitable beneficiaries for life or for a term of years with an irrevocable remainder interest held for the benefit of charity. Section 664(c) provides that a charitable remainder trust is exempt from all taxes under subtitle A of the Code for any taxable year except a taxable year in which the trust has unrelated business taxable income under section 512.

There are two types of charitable remainder trusts. A charitable remainder annuity trust (a CRAT) pays a sum certain at least annually to one or more noncharitable beneficiaries. A charitable remainder unitrust (a CRUT) pays a unitrust amount at least annually to one or more noncharitable beneficiaries. The unitrust amount is generally a fixed percentage of the net fair market value of the CRUT's assets valued annually (the fixed percentage method). The unitrust amount can instead be the lesser of the fixed percentage amount or the trust's net income (the net income method). Alternatively, the unitrust amount can be the amount determined under the net income method plus any amount of income that exceeds the current year's fixed percentage amount to "make up" for any shortfall in distributions in prior years when the trust income was less than the fixed percentage amount (the NIMCRUT method). Explanation of

Provisions

I. Flip Unitrusts

A. General Explanation

The governing instrument of a CRUT must specify the method of computing the unitrust payments. Section 664(d)(3) provides that the income exception methods (either the net income method or the NIMCRUT method) may be used to pay the unitrust amount "for any year." The legislative history, however, provides that the method used to determine the unitrust amount may not be discretionary with the trustee. H.R. Conf. Rep. No. 782, 91st Cong., 1st Sess. 296 (1969), 1969-3 C.B. 644, 655.

Some donors may fund a CRUT with unmarketable assets that produce little or no income. These donors often want the income beneficiary or beneficiaries of the CRUT to receive a steady stream of payments based on the total return available from the value of the assets. The donors recognize, however, that the CRUT cannot make these payments until it can convert the unmarketable assets into liquid assets that can be used to pay the fixed percentage amount. These donors establish CRUTs that use one of the income exception methods to calculate the unitrust amount until the unmarketable assets are sold. Following the sale, the donors may prefer that the CRUT use the fixed percentage method to calculate the unitrust amount. A trust using such a combination of methods would be a "flip unitrust."

The proposed regulations provide that a donor may establish a flip unitrust that qualifies as a CRUT if the following conditions are satisfied. First, to ensure that the CRUT has substantially all unmarketable assets prior to the switch in methods, at least 90 percent of the fair market value of the assets held in the trust immediately after the initial contribution or any subsequent contribution (prior to the switch in methods) must consist of unmarketable assets. Unmarketable assets are assets that are not cash, cash equivalents, or marketable securities (within the meaning of section 731(c)).

Second, because the legislative history indicates that a trustee should not have discretion to change the method used to calculate the unitrust amount, the governing instrument must provide that the CRUT will use an income exception method until the earlier of (a) the sale of a specified unmarketable asset or group of unmarketable assets contributed at the time the trust was created or (b) the sale of unmarketable assets such that immediately following the sale, any remaining unmarketable assets total 50 percent or less of the fair market value of the trust's assets. For making this determination, the remaining unmarketable assets are valued as of the most recent valuation date.

Third, to ensure that the CRUT will use the fixed percentage method after the unmarketable assets are sold, the CRUT must switch exclusively to the fixed percentage method for calculating all remaining unitrust amounts payable to any income beneficiary at the beginning of the first taxable year following the year in which the earlier of the above events occurs.

Finally, because the fixed percentage method does not provide for a makeup amount, any makeup amount described in section 664(d)(3)(B) is forfeited when the trust switches to the fixed percentage method.

The IRS and Treasury request comments on whether there are additional circumstances under which a combination of methods should be addressed in regulations.

B. Proposed Effective Date and Transitional Rules

The amendments allowing a flip unitrust are proposed to be effective for CRUTs created on or after the date the final regulations are published in the **Federal Register**.

If a trust was created before the effective date of this amendment and its governing instrument contains a flip provision other than the one permitted by the regulations, the trust may be amended or reformed to comply with the final regulations. If a trust is created after the effective date of this amendment and has a flip provision not expressly permitted by the regulations, the trust will qualify as a CRUT if it is amended or reformed to use the initial method for computing the unitrust amount throughout the term of the trust. If a qualified CRUT is created before or after the effective date of this amendment and its governing instrument does not contain a flip provision, the trust will not continue to qualify as a CRUT if it is amended or reformed to add a flip provision.

The IRS and Treasury invite comments on the least burdensome methods of changing the terms of a trust's governing instrument.

II. Time for Paying the Annuity Amount or the Unitrust Amount

A. General Explanation

The regulatory provisions permitting a trustee of a charitable remainder trust to pay the annuity or unitrust amount within a reasonable period of time following the close of the trust's taxable year were intended as an administrative convenience for trustees. Under the income exception methods, the trustee may not be able to determine the amount of trust income and, thus, the amount to be distributed for a trust's taxable year until after the close of that year. Therefore, a trustee may need the additional time to pay the unitrust amount if a CRUT uses one of the income exception methods.

In contrast, a trustee of a CRAT or a CRUT using the fixed percentage method can easily determine the annuity or unitrust amount and pay it before the close of the taxable year to which it relates. The annuity amount is fixed and determinable as of the date the trust is created. The fixed percentage unitrust amount is fixed and determinable as of the annual valuation date, which is specified in the governing instrument or on the initial Form 5227, Split-Interest Trust Information Return. The valuation date can be set well before the end of the taxable year.

The IRS and Treasury believe that certain trustees of charitable remainder trusts have attempted to abuse the provi-

sions in the current regulations that permit a trustee to pay the annuity or unitrust amount within a reasonable time after the close of the taxable year for which the payment is due. The IRS and Treasury are especially concerned about accelerated charitable remainder trusts described in Notice 94-78 (1994-2 C.B. 555). Therefore, the regulations propose to amend §§ 1.664-2(a)(1)(i) and 1.664-3(a)(1)(i) to provide that the payment of the annuity amount or the unitrust amount determined under the fixed percentage method must be made by the close of the taxable year in which it is due. These proposed amendments should not require the amendment or reformation of governing instruments of existing charitable remainder trusts that allow a trustee to pay the unitrust or annuity amount after the close of the taxable year. The trustees of such trusts can comply with the proposed regulations by actually paying the annuity or unitrust amount within the time permitted by the proposed amendments.

For CRUTs using an income exception method, the regulations continue to provide that if the CRUT pays the unitrust amount within a reasonable time after the close of the trust's taxable year, the trust is not deemed to have engaged in an act of self-dealing, to have unrelated debt-financed income, to have received an additional contribution, or to have failed to function exclusively as a charitable remainder trust.

B. Proposed Effective Date

These amendments are proposed to be effective for taxable years ending after April 18, 1997.

The IRS will continue to challenge the purported tax consequences of accelerated charitable remainder trusts as described in Notice 94-78.

III. Appraising Unmarketable Assets

A. General Explanation

Under § 1.664-1(a)(1)(iii)(a), a trust may qualify as a charitable remainder trust only if a deduction is allowable under sections 170, 2055, 2106, or 2522 for transfers to the trust. The legislative history of section 664 indicates that Congress contemplated denying a charitable contribution deduction to a donor who transferred unmarketable assets to a charitable remainder trust unless an independent trustee valued the assets. H.R. Rep. No. 413, 91st Cong., 1st Sess. 60 (1969), 1969-3 C.B. 200, 239. Because the statute does not contain a corre-

sponding provision, many practitioners have asked whether a charitable remainder trust that holds unmarketable assets must have an independent trustee value the assets.

The proposed regulations provide that if a charitable remainder trust holds unmarketable assets and the trustee is the grantor of the charitable remainder trust, a noncharitable beneficiary, or a related or subordinate party to the grantor or the noncharitable beneficiary within the meaning of section 672(c) and the applicable regulations, the trustee must use a current qualified appraisal, as defined in § 1.170A-13(c)(3), from a qualified appraiser, as defined in § 1.170A-13(c)(5), to value those assets. A trustee who is not the grantor, a noncharitable beneficiary, or a related or subordinate party does not have to use a qualified appraisal from a qualified appraiser to value the unmarketable assets. Therefore, the grantor, a noncharitable beneficiary, or a related or subordinate party may be the sole trustee of a charitable remainder trust if the trustee uses a current qualified appraisal from a qualified appraiser to compute the fair market value of the trust's unmarketable assets.

B. Proposed Effective Date

The amendments are proposed to be effective for trusts created on or after the date on which the final regulations are published in the **Federal Register**. If the governing instrument of an existing trust created before the effective date of this amendment already requires an independent trustee to value the trust's unmarketable assets, the governing instrument may be amended or reformed to conform with this provision.

IV. Application of Section 2702 to Certain Charitable Remainder Unitrusts

A. General Explanation

Section 2702 provides special rules to determine the amount of the gift when an individual makes a transfer in trust to or for the benefit of a family member and the individual or an applicable family member retains an interest in the trust. Under section 2702(a), the retained interest in these situations is generally valued at zero unless the interest is a qualified interest. Under section 2702(b), a qualified interest includes the right to receive fixed payments at least annually and the right to receive amounts at least annually that are a

fixed percentage of the annual fair market value of the property in the trust.

Section 2702(a)(3)(A)(iii) was added by section 1702(f)(11)(A)(iv) of the Small Business Job Protection Act of 1996 (Public Law 104-188) as a technical correction to the Revenue Reconciliation Act of 1990 (Public Law 101-508). Section 2702(a)(3)(A)(iii) provides that section 2702(a) shall not apply to any transfer to the extent regulations provide that such transfer is not inconsistent with the purposes of the section. According to the legislative history, the regulatory authority could be used to create an exception from the application of section 2702 for a qualified charitable remainder trust that does not otherwise create an opportunity for transferring property to a family member free of transfer tax. H.R. Rep. No. 586, 104th Cong., 2d Sess. 155-56 (1996). Under § 25.2702-1(c)(3) of the Gift Tax Regulations, section 2702 does not apply to CRUTs or CRATs.

Some taxpayers have created CRUTs using an income exception method to take advantage of the section 2702 exclusion granted to charitable remainder trusts in the regulations. These taxpayers attempt to use this exclusion and the income exception feature of a CRUT to pass substantial assets to family members with minimal transfer tax consequences.

For example, a donor establishes a NIMCRUT to pay the lesser of trust income or a fixed percentage to the donor for a term of 15 years or his life, whichever is shorter, and then to the donor's daughter for her life. If the tables under section 7520 are used to value the donor's retained interest and the donor's gift to the daughter, the amount of the donor's gift to the daughter is relatively small compared to the amount the daughter may actually receive. To illustrate, the trustee may invest in assets that produce little or no trust income while the donor retains the unitrust interest, creating a substantial makeup amount. At the end of the donor's interest, the trustee alters the NIMCRUT's investments to generate significant amounts of trust income. The trustee then uses the income to pay to the donor's daughter the current fixed percentage amount and the makeup amount, which includes the makeup amount accumulated while the donor was the unitrust recipient.

The use of a CRUT as described in the above example permits the shifting of a beneficial interest in the trust from

the donor to another family member and, thus, creates an opportunity for transferring property to a family member free of transfer tax that is contrary to section 2702(a)(3)(A)(iii). Therefore, the proposed regulations will amend § 25.2702-1(c)(3) to provide that the unitrust interests in a CRUT using an income exception method retained by the donor or any applicable family member will be valued at zero when someone other than (1) the donor, (2) the donor's spouse, or (3) both the donor and the donor's spouse (who is a citizen of the U.S.) is a noncharitable beneficiary of the trust. In these situations, the value of the donor's gift is the fair market value of all the property transferred to the CRUT. The present value of the remainder interest passing to the charitable organization will qualify for the deduction under section 2522. Accordingly, the amount used to calculate the donor's gift tax liability is the value of the property transferred to the trust less the value of the interest passing to charity.

Section 25.2702-1(c)(3) will continue to exclude from the application of section 2702 transfers to pooled income funds described in section 642(c)(5) and to CRATs and CRUTs that pay the unitrust amount under the fixed percentage method.

B. Proposed Effective Date

This amendment is proposed to be effective for transfers in trust made on or after May 19, 1997.

V. Prohibition on Allocating Pre-contribution Gain to Trust Income

A. General Explanation

When assets are transferred to a charitable remainder trust, the amount of the donor's charitable deduction is generally based in part on the fair market value of the property transferred to the trust. Although an income exception CRUT provides a different method for calculating the unitrust amount than a fixed percentage CRUT, any charitable deduction for an income exception CRUT is calculated as if the fixed percentage is distributed each year. Allocating amounts to trust income that are part of the fair market value of the contributed property on which the charitable deduction was based would be inconsistent with Congress's intent to assure that the amount claimed as a charitable deduction for the contribution to the trust relates to the projected growth of the assets contributed less the

expected distributions to the income beneficiaries. H.R. Rep. No. 413, 91st Cong., 1st Sess. 58-59 (1969), 1969-3 C.B. 200, 237-38; S. Rep. No. 552, 91st Cong., 1st Sess. 87 (1969), 1969-3 C.B. 423, 479. Therefore, the regulations clarify that the proceeds from the sale of an income exception CRUT's assets, at least to the extent of the fair market value of the asset when contributed to the trust, must be allocated to principal.

B. Proposed Effective Date

This amendment is proposed to be effective for sales or exchanges after April 18, 1997. For sales or exchanges on or before the effective date of this amendment, the Service will continue to challenge any attempt to allocate pre-contribution gain to trust income as being fundamentally inconsistent with applicable local law and with the amount of the charitable deduction claimed.

VI. Example Illustrating Rule for Characterizing Distributions from CRUTs

Section 664(b) contains the ordering rule used to determine the character of the annuity or unitrust amount in the hands of the recipient. The legislative history states that the ordering rule applies to both CRATs and CRUTs. S. Rep. No. 552, 91st Cong., 1st Sess. 90 (1969), 1969-3 C.B. 423, 481. The ordering rule applies to the unitrust amounts received from all CRUTs regardless of the method used by the CRUT to determine the unitrust amount.

Although the current regulations clearly provide that the ordering rule of section 664(b) and § 1.664-1(d)(1)(i) applies to all unitrust amounts received from CRUTs, some practitioners have asked whether the ordering rule applies to unitrust amounts paid under the income exception methods. To provide taxpayers with additional guidance, the proposed regulations add an example of how the ordering rule operates when the unitrust amount is computed under an income exception method.

VII. Request for Comments on Income Exception CRUTs Holding Certain Investments

The IRS and Treasury are aware that taxpayers are using income exception CRUTs to take advantage of the timing difference between the receipt of trust income (as defined in section 643(b)) and income for federal income tax purposes. For example, an income excep-

tion CRUT may hold an interest in a partnership controlled by a trustee of the trust, a grantor, a beneficiary, or a party related or subordinate to the trustee, the grantor, or a beneficiary. In such a case, an interested party controls when the trust will receive the earnings from its partnership interest and, accordingly, when the unitrust recipient will receive distributions from the trust. Although the income exception CRUT has taxable income on its distributive share of partnership items, the trust does not have trust income until it actually receives a distribution of its share of the partnership's earnings.

The IRS and Treasury are studying whether investing the assets of an income exception CRUT to take advantage of the timing difference between the receipt of trust income and income for federal tax purposes causes the trust to fail to function exclusively as a charitable remainder trust. Therefore, the IRS and Treasury request comments on drafting future guidance on this issue. Revenue Procedure 97-23, to be published on April 28, 1997, in Internal Revenue Bulletin 1997-17, provides that the IRS will not issue letter rulings on whether a trust that will calculate the unitrust amount under section 664(d)(3) qualifies as a section 664 charitable remainder trust when a grantor, a trustee, a beneficiary, or a person related or subordinate to a grantor, a trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under section 643(b) and income for federal income tax purposes for the benefit of the unitrust recipient.

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 is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the recordkeeping requirement in these regulations does not affect small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submit-

ted 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 comments that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 9, 1997, at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Ave, 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 comments by August 19, 1997, and submit an outline of the topics to be discussed and the time to be devoted to each topic by August 19, 1997.

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 Mary Beth Collins and Jeffrey A. Erickson, Office of the Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, personnel from other offices of the IRS and Treasury Department participated in their development.

* * * * *

26 CFR Part 25

Gift taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, CFR parts 1 and 25 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In § 1.664-1, paragraphs (a)(7), (d)(1)(iii), and (f)(4) are added to read as follows (paragraph (f)(4) follows the concluding text of paragraph (f)(3)):

§ 1.664-1 Charitable remainder trusts.

(a) * * *

(7) *Valuation of unmarketable assets.* If a trust has assets that are not cash, cash equivalents, or marketable securities (within the meaning of section 731(c) and the applicable regulations) and the trustee is the grantor of the charitable remainder trust, a noncharitable beneficiary, or a related or subordinate party to the grantor or noncharitable beneficiary within the meaning of section 672(c) and the applicable regulations, the trustee must use a current qualified appraisal, as defined in § 1.170A-13(c)(3), from a qualified appraiser, as defined in § 1.170A-13(c)(5), to value those assets. A trustee who is not the grantor of the charitable remainder trust, a noncharitable beneficiary, or a related or subordinate party to the grantor or noncharitable beneficiary does not have to use a current qualified appraisal from a qualified appraiser to value the trust's assets.

* * * * *

(d) * * *

(1) * * *

(iii) *Example.* The following example illustrates the application of this paragraph (d)(1):

Example. (i) X is a charitable remainder unitrust described in sections 664(d)(2) and (3). The annual unitrust amount is the lesser of the amount of trust income, as defined in § 1.664-3(a)(1)(i)(b)(3), or six percent of the net fair market value of the trust assets valued annually. The net fair market value of the trust assets on the valuation date in 1996 is \$150,000. During 1996, X has \$7,500 of income after allocating all expenses. All of X's income for 1996 is tax-exempt income. At the end of 1996, X's ordinary income for the current taxable year and undistributed ordinary income for prior years are both zero; X's capital gain for the current taxable year is zero and undistributed capital gain for prior years is \$30,000; and X's tax-exempt income for the current year is \$7,500 and undistributed tax-exempt income for prior years is \$2,500.

(ii) Because the trust income of \$7,500 is less than the fixed percentage amount of \$9,000, the unitrust amount for 1996 is \$7,500. The character of that amount in the hands of the recipient of the unitrust amount is determined under section 664(b). Because the unitrust amount is less than X's undistributed capital gain income, the recipient of the unitrust amount treats the distribution of \$7,500 as capital gain. At the beginning of 1997, X's undistributed capital gain for prior years is reduced to \$22,500, and X's undistributed tax-exempt income is increased to \$10,000.

* * * * *

(f) * * *

(4) *Valuation of unmarketable assets.* The rules contained in paragraph (a)(7) of this section are effective for trusts created on or after the date the final regulations are published in the **Federal Register**. A trust whose governing instrument requires that an independent trustee value the trust's unmarketable assets may be amended or reformed to permit any trustee to value those assets if the trustee uses a current qualified appraisal, as defined in § 1.170A-13(c)(3), from a qualified appraiser, as defined in § 1.170A-13(c)(5), in the taxable years beginning on or after the date the final regulations are published in the **Federal Register**.

* * * * *

Par. 3. In § 1.664-2, paragraph (a)(1)(i) is revised to read as follows:

§ 1.664-2 Charitable remainder annuity trust.

(a) * * *

(1) * * * (i) *Payment of sum certain at least annually.* The governing instrument provides that the trust will pay a sum certain not less often than annually to a person or persons described in paragraph (a)(3) of this section for each taxable year of the period specified in paragraph (a)(5) of this section. The annuity amount must be paid to the recipient no later than the close of the taxable year for which the payment is due. The rules contained in this paragraph (a)(1)(i) are effective for taxable years ending after April 18, 1997.

* * * * *

Par. 4. Section 1.664-3 is amended as follows:

1. Paragraphs (a)(1)(i)(a), (a)(1)(i)(b)(1), and (a)(1)(i)(b)(2) are revised.

2. Paragraphs (a)(1)(i)(b)(3), (a)(1)(i)(c), (a)(1)(i)(d), (a)(1)(i)(e), and (a)(1)(i)(f) are added.

3. The third sentence of paragraph (a)(1)(iv) is revised.

4. Paragraph (a)(1)(vi) is added.

The added and revised provisions read as follows:

§ 1.664-3 Charitable remainder unitrust.

(a) * * *

(1) * * *

(i) * * * (a) *General rule.* The governing instrument provides that the trust will pay not less often than annually a fixed percentage of the net fair market value of the trust assets determined annually to a person or persons described in paragraph (a)(3) of this section

for each taxable year of the period specified in paragraph (a)(5) of this section.

(b) * * *

(1) The amount of trust income for a taxable year to the extent that such amount is not more than the amount required to be distributed under paragraph (a)(1)(i)(a) of this section.

(2) An amount of trust income for a taxable year that is in excess of the amount required to be distributed under (a)(1)(i)(a) of this section for such year to the extent that (by reason of paragraph (a)(1)(i)(b)(1) of this section) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

(3) For this paragraph (a)(1)(i)(b), trust income means income as defined under section 643(b) and the applicable regulations. Proceeds from the sale or exchange of any assets contributed to the trust by the donor must be allocated to principal and not to trust income at least to the extent of the fair market value of those assets on the date of contribution.

(c) *Combination of methods.* Instead of the amount described in paragraph (a)(1)(i)(a) or (b) of this section, the governing instrument may provide that the trust will pay the amount described in paragraph (a)(1)(i)(b) of this section for an initial period and then pay the amount described in paragraph (a)(1)(i)(a) of this section (calculated using the same fixed percentage) for the remaining years of the trust if—

(1) At least 90 percent of the fair market value of the assets held in the trust immediately after either the initial contribution or any subsequent contribution (prior to the change in methods) to the trust consists of unmarketable assets;

(2) The governing instrument provides that the change of method described in this paragraph (a)(1)(i)(c) will be triggered by the earlier of—

(i) The sale or exchange of a specified asset or group of assets that was contributed to the trust on its creation; or

(ii) The sale or exchange of unmarketable assets if immediately following the sale or exchange, the fair market value of any remaining unmarketable assets total 50 percent or less of the total fair market value of the trust's assets. For making this determination, the remaining unmarketable assets must be valued as of the most recent valuation date;

(3) The change of method described

in this paragraph (a)(1)(i)(c) takes effect at the beginning of the first taxable year following the year in which the earlier of paragraph (a)(1)(i)(c)(2)(i) or (ii) of this section occurs; and

(4) Following the trust's conversion to the method described in paragraph (a)(1)(i)(a) of this section, the trust will pay at least annually to the permissible recipients the amount described only in paragraph (a)(1)(i)(a) of this section and not any amount described in paragraph (a)(1)(i)(b) of this section.

(5) For this paragraph (a)(1)(i)(c), unmarketable assets are assets that are not cash, cash equivalents, or marketable securities as defined in section 731(c) and the applicable regulations.

(d) *Example.* The following example illustrates the rules in paragraph (a)(1)(i)(c) of this section:

Example. (i) On the creation of charitable remainder unitrust Y, S contributes four assets—A, B, C, and D. A is a marketable security under section 731(c) and the applicable regulations. B, C, and D are unmarketable assets. The fair market value of B, C, and D is at least 90 percent of the fair market value of all four assets at the time of contribution.

(ii) The governing instrument of Y provides for calculating the unitrust amount under the combination of methods described in paragraph (a)(1)(i)(c) of this section. The initial method for calculating the unitrust amount is the lesser of the amount of trust income, as defined in paragraph (a)(1)(i)(b)(3) of this section, or six percent of the net fair market value of the trust assets valued annually. The unitrust amount also includes any amount of trust income for any taxable year that exceeds six percent of the net fair market value of the trust's assets valued annually to the extent the total of the amounts paid in prior years was less than the total of the amounts computed as six percent of the net fair market value of Y's assets on the valuation dates. After the change in method, the unitrust amount will equal six percent of the net fair market value of Y's assets on the valuation dates.

(iii) The governing instrument provides that the change in method will occur for the first taxable year beginning after both B and C are sold or the year in which the trust has sold or exchanged enough unmarketable assets so that the remaining unmarketable assets total 50 percent or less of the fair market value of the trust's assets, whichever occurs first.

(iv) In Year 3, the trustee of Y sells B, one of the three unmarketable assets. After the sale of B, the fair market value of all of Y's unmarketable assets is greater than 50 percent of the fair market value of Y's assets. Therefore, in Year 3, the method used to calculate the unitrust amount remains the initial method.

(v) In Year 4, the trustee sells D. After the sale of both B and D, the fair market value of Y's unmarketable assets is 50 percent or less of the fair market value of Y's assets. In Year 4, however, the method used to calculate the unitrust amount remains the initial method.

(vi) In Year 5 and for all subsequent years, the trust must pay a unitrust amount equal only to six percent of the net fair market value of Y's assets determined annually. The change in method occurs

in Year 5 because the fair market value of Y's unmarketable assets totaled 50 percent or less of the fair market value of Y's assets after the sale of both B and D. The change in method occurs even though Y still owns C, the other unmarketable asset specified in the governing instrument.

(vii) By the end of Year 4, Y's total trust income had been less than the sum of the unitrust amounts based on six percent of the net fair market value of Y's assets determined annually, leaving a balance of \$1,000. The \$1,000 balance can never be distributed to the unitrust recipient after the change to the fixed percentage method.

(e) *Payment under general rule.* When the unitrust amount is computed under paragraph (a)(1)(i)(a) of this section, the unitrust amount must be paid to the recipient no later than the close of the taxable year of the trust for which the payment is due.

(f) *Payment under income exception.* When the unitrust amount is computed under paragraph (a)(1)(i)(b) of this section, the unitrust amount may be paid to the recipient after the close of the taxable year of the trust for which the payment is due if paid within a reasonable time after the close of such taxable year. The trust will not be deemed to have engaged in an act of self-dealing (within the meaning of section 4941), to have unrelated debt-financed income (within the meaning of section 514), to have received an additional contribution (within the meaning of paragraph (b) of this section), or to have failed to function exclusively as a charitable remainder trust (within the meaning of paragraph (a)(4) of this section) merely because payment of the unitrust amount is made after the close of the taxable year if such payment is made within a reasonable time after the close of such taxable year. For this paragraph (a)(1)(i)(f), a reasonable time will not ordinarily extend beyond the date by which the trustee is required to file Form 5227, Split-Interest Trust Information Return, (including extensions) for the taxable year.

* * * * *

(iv) * * * If the governing instrument does not specify the valuation date or dates, the trustee must select such date or dates and indicate the selection on the first return on Form 5227, Split-Interest Trust Information Return, that the trust must file. * * *

* * * * *

(vi) *Effective date and reformations.* (a) The rules in paragraph (a)(1)(i)(a) of this section are effective for taxable years ending after April 18, 1997.

(b) The rules in paragraphs (a)(1)(i)(c) and (d) of this section are effective for charitable remainder

unitrusts created on or after the date the final regulations are published in the **Federal Register**. If a trust was created before the effective date of paragraph (a)(1)(i)(c) of this section and contains a provision allowing a change in calculating the unitrust method, the trust may be amended or reformed to comply with the provisions of paragraph (a)(1)(i)(c) of this section. If a trust is created after the effective date of paragraph (a)(1)(i)(c) of this section and contains a provision allowing a change in calculating the unitrust method that does not comply with the provisions of paragraph (a)(1)(i)(c) of this section, the trust will continue to qualify as a charitable remainder unitrust if it is amended or reformed to use the initial method for computing the unitrust amount throughout the term of the trust. A qualified charitable remainder unitrust created before or after the effective date of paragraph (a)(1)(i)(c) of this section will not continue to qualify as a charitable remainder unitrust if its governing instrument is amended or reformed to add a provision allowing a change in the method for calculating the unitrust amount.

(c) The rules in paragraphs (a)(1)(i)(b)(1), (2), and (3) of this section are effective for taxable years ending after April 18, 1997, and for sales or exchanges described in paragraph (a)(1)(i)(b)(3) of this section that occur after April 18, 1997.

(d) The rules in paragraphs (a)(1)(i)(e) and (f) of this section are effective for taxable years ending after April 18, 1997.

* * * * *

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. The authority for part 25 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 6. In § 25.2702-1, paragraph (c)(3) is revised to read as follows:

§ 25.2702-1 *Special valuation rules in the case of transfers of interests in trust.*

* * * * *

(c) * * *

(3) *Charitable remainder trust.* (i) For transfers made on or after May 19, 1997, a transfer to a pooled income fund described in section 642(c)(5); a transfer to a charitable remainder annuity trust described in section 664(d)(1); a transfer to a charitable remainder unitrust described in section 664(d)(2) if under the terms of the governing instrument the

unitrust amount is computed only under section 664(d)(2)(A); and a transfer to a charitable remainder unitrust described in sections 664(d)(2) and (3) if the only permitted recipients of the unitrust amount are the donor, the donor's spouse, or both the donor and the donor's spouse who is a citizen of the United States.

(ii) For transfers made before May 19, 1997, a transfer in trust if the remainder interest in the trust qualifies for a deduction under section 2522.

* * * * *

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on April 17, 1997, 8:45 a.m., and published in the issue of the Federal Register for April 18, 1998, 62 F.R. 19072)

Notice of Disposition of Declaratory Judgment Proceedings Under Section 7428

This announcement serves notice to donors that by agreement of the parties, the organization listed below is an organization exempt from taxes under Internal Revenue Code section 501(a) as an organization described in IRC section 501(c)(3).

Jack Rehburg Ministries a/k/a Total Christian Television
Snow Camp, NC

Foundations Status of Certain Organizations

Announcement 97-46

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

African Connection, Inc., Cambridge, MA
Alcohol and Drug Abuse Recovery Environment, Inc., Houston, TX
American Friends of the Imperial War Museum, St. Louis, MO
Americas Business Conscience Corp., Scarsdale, NY
Arts for Life, Albuquerque, NM
Asanteman Association of Greater Houston, Missouri City, TX
Association for Christian Public School Teachers and Administrators, Stillwater, OK
Association for Recreation as an Alternative, Inc., New York, NY
Association of Hispanic Educators of Massachusetts, Inc., Springfield, MA
BAA & Company, San Antonio, TX
Ballet, Inc., New York, NY
Barbara Oneglia Alvarez Tyciensi Christmas Fund for Needy Children, Torrington, CT
Becket Land Trust, Inc., Becket, MA
Bellevue Avalon Girls Association, Bellevue, PA
Bethany Center Inc., Lakeland, FL
Birthright of Encinitas, Encinitas, CA
Black Transplants Action Committee, Denver, CO
Choices Inc., A Cancer Survivor Advocate Group, Prairie Village, KS
Christian Medical Missions, Inc., Woodward, OK
Christian Medical Relief International, Inc., Tulsa, OK
Christian Mission Resident Ministry Corp., St. Petersburg, FL
Christian Support Ministries, Houston, TX
Christian United Enterprise Non-Profit Housing Corporation, Flint, MI
Christians United Productions, Littleton, CO
Christine Historical Society, Christine, TX
Circle S. Rodeo Ministries, Inc., Trinity, TX
Citadel Gymnastics Association, Tulsa, OK
Citizens Crime Line of Gaines County, Inc., Seagraves, TX
City of Deer Park Texas Senior Citizens Foundation Trust, Deer Park, TX
Clayton Community Center, Inc., Clayton, KS
Clear Thinking, Inc., Scottsdale, AZ
Cliff Haven Adult Day Health Care, Inc., Dallas, TX
Clinton Crimestoppers, Clinton, OK
C. N. Linscott Memorial Childrens Foundation, Austin, TX
Colorado Coaches of Girls Sports, Broomfield, CO
Colorado Health Policy Council, Denver, CO
Colorado Operation Lifesaver, Inc., Denver, CO
Colorado Springs Parents of Prematures, Colorado Springs, CO
Colorado Yale Association, Denver, CO
Colors of Life, Inc., Lawton, OK
Colquitt-Miller County Historic and Economic Revitalization Organization, Inc., Colquitt, GA
Columbus Community Foundation, Columbus, KS
Contemporary Housing Alternatives Inc., Topeka, KS
Cross Country Ministries, Buckeye, AZ
Dinosaurland Resource Conservation & Development Area, Vernal, UT
Disadvantaged Business Development Association, Youngstown, OH
Firecon Institute for Research and Education, Inc., East Earl, PA
Five Moons Theatre, Inc., New York, NY
For the Record, Inc., Los Angeles, CA
Friends of Father Joseph Inc., Baltimore, MD
Give One Day Inc., Austin, TX
Gospel for India, Dallas, TX
Heavens Gate Ministries, Inc., Nowata, OK
Heber Overgaard Economic Development Corporation, Overgaard, AZ
Helping Hands Community Resource Center, Beckley, WV
Helping Horse Therapeutic Riding Center, Thermopolis, WY
Henderson Junior High School Parent, Inc., China, TX
Hendrick Academy of Honor Inc., Plano, TX
High Frequency Wavelengths, Virginia Beach, VA
Holdenville General Hospital Foundation, Holdenville, OK
Johnston-Mitchell Preservation Foundation, Inc., Plano, TX
John Wesley White Franklin Graham Desert Southwest Crusade, Yuma, AZ
Little Britches Rodeo Association of Texas, Bandera, TX
Littlefield Arts and Heritage Committee, Inc., Lubbock, TX
Living Improvements for Elderly, Port Neches, TX
MGA Golf Foundation, Jefferson City, MO
Mile by Mile Inc., Mesa, AZ
Missouri City Girls Softball Association, Missouri City, TX
Mohave County Trails Association Inc., Kingman, AZ
Mojave Native Plant Society, Las Vegas, NV
Montebello-El Rosario Sister City Association, Montebello, CA
Montgomery County Master Gardener Association, Conroe, TX
Northeastern Connecticut Aids Project, Inc., Pomfret Center, CT
Our Lady of Fatima Sanctuary Inc., Anchorage, AK
Pend'Orelle County District 3 Firemans Fund, Newport, WA
Permian Basin Aids Coalition, Midland, TX
Permian Choir Booster Club, Odessa, TX
Poltava Center, Inc., Beachwood, OH
Prairie Preservation Incorporated, Fennimore, WI
Rio Grande Dispute Resolution Center, Inc., El Paso, TX
River of Light Christian Ministries, Phoenix, AZ
Riverside Recover Center, Inc., Houston, TX
Sagebrush Bible Chapel Inc., Sparks, NV
Southwestern Native American Art Foundation, Albuquerque, NM
Space Science Educational Foundation for Tomorrow, Inc., Sugarland, TX
Sparta-White County Main Street, Sparta, TN
Sports for Life, Inc., Oklahoma City, OK
Sports Turf Managers Benevolent Foundation, Aurora, CO
Stinesville Renaissance Group, Stinesville, IN
Stop Six Community Services, Inc., Fort Worth, TX
Sunshine House Foundation, Denver, CO
Upper Valley Foundation, White River Jct., VT
Vivid Theater Ensemble, Dallas, TX
Vore Buffalo Jump Foundation, Sundance, WY
West Allegheny Chorus Boosters, Imperial, PA
West Coast Dance Project Inc., Sarasota, FL
Women Against Violence Everywhere, Westminster, CA
Woodstock Academy Inc., Woodstock, MD
Working Theatre, Cleveland, OH
Wyoming Pioneer Woman, Worland, WY

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will

issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such

ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce

such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Expedited Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under title 31 of the Code of Federal Regulations, section 10.76, the Director of Practice is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years, from the date the expedited proceeding is instituted, (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause; or (2) has been convicted of any crime under title 26 of the United States Code or, of a felony under title 18 of the United States Code involving dishonesty or breach of trust.

Attorneys, certified public accountants, enrolled agents and enrolled actu-

aries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under expedited suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public

accountant, enrolled agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions of the applicable regulations:

Name	Address	Designation	Date of Suspension
Loberg, Thomas	St. Paul, MN	CPA	Indefinite from November 13, 1996
Rose Ann Galati	Thousand Oaks, CA	CPA	Indefinite from November 25, 1996
Labendeira, Anthony	Fresno, CA	CPA	Indefinite from November 25, 1996
Nation, D. Mark	Albuquerque, NM	CPA	Indefinite from November 25, 1996
Behren, Daryl D.	Visalia, CA	CPA	Indefinite from November 25, 1996
Murphy, Virginia T.	Laurinburg, NC	CPA	Indefinite from November 25, 1996
Best III, James M.	Monroe, NC	CPA	Indefinite from November 25, 1996
Rehm, Aysha	Tulsa, OK	CPA	Indefinite from November 25, 1996
Dineen, Lee M.	Castle Hayne, NC	CPA	Indefinite from December 12, 1996
Miele, Ralph J.	North Babylon, NY	CPA	Indefinite from February 14, 1997

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling

is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does

more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.

Acq.—Acquiescence.

B—Individual.

BE—Beneficiary.

BK—Bank.

B.T.A.—Board of Tax Appeals.

C.—Individual.

C.B.—Cumulative Bulletin.

CFR—Code of Federal Regulations.

CI—City.

COOP—Cooperative.

Ct.D.—Court Decision.

CY—County.

D—Decedent.

DC—Dummy Corporation.

DE—Donee.

Del. Order—Delegation Order.

DISC—Domestic International Sales Corporation.

DR—Donor.

E—Estate.

EE—Employee.

E.O.—Executive Order.

ER—Employer.

ERISA—Employee Retirement Income Security Act.

EX—Executor.

F—Fiduciary.

FC—Foreign Country.

FICA—Federal Insurance Contribution Act.

FISC—Foreign International Sales Company.

FPH—Foreign Personal Holding Company.

F.R.—Federal Register.

FUTA—Federal Unemployment Tax Act.

FX—Foreign Corporation.

G.C.M.—Chief Counsel's Memorandum.

GE—Grantee.

GP—General Partner.

GR—Grantor.

IC—Insurance Company.

I.R.B.—Internal Revenue Bulletin.

LE—Lessee.

LP—Limited Partner.

LR—Lessor.

M—Minor.

Nonacq.—Nonacquiescence.

O—Organization.

P—Parent Corporation.

PHC—Personal Holding Company.

PO—Possession of the U.S.

PR—Partner.

PRS—Partnership.

PTE—Prohibited Transaction Exemption.

Pub. L.—Public Law.

REIT—Real Estate Investment Trust.

Rev. Proc.—Revenue Procedure.

Rev. Rul.—Revenue Ruling.

S—Subsidiary.

S.P.R.—Statements of Procedural Rules.

Stat.—Statutes at Large.

T—Target Corporation.

T.C.—Tax Court.

T.D.—Treasury Decision.

TFE—Transferee.

TFR—Transferor.

T.I.R.—Technical Information Release.

TP—Taxpayer.

TR—Trust.

TT—Trustee.

U.S.C.—United States Code.

X—Corporation.

Y—Corporation.

Z—Corporation.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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(lo), (lp), (lq), (lr), (ls), (lt), (lu), (lv), (lw), (lx), (ly), (lz), (ma), (mb), (mc), (md), (me), (mf), (mg), (mh), (mi), (mj), (mk), (ml), (mm), (mn), (mo), (mp), (mq), (mr), (ms), (mt), (mu), (mv), (mw), (mx), (my), (mz), (na), (nb), (nc), (nd), (ne), (nf), (ng), (nh), (ni), (nj), (nk), (nl), (nm), (nn), (no), (np), (nq), (nr), (ns), (nt), (nu), (nv), (nw), (nx), (ny), (nz), (oa), (ob), (oc), (od), (oe), (of), (og), (oh), (oi), (oj), (ok), (ol), (om), (on), (oo), (op), (oq), (or), (os), (ot), (ou), (ov), (ow), (ox), (oy), (oz), (pa), (pb), (pc), (pd), (pe), (pf), (pg), (ph), (pi), (pj), (pk), (pl), (pm), (pn), (po), (pp), (pq), (pr), (ps), (pt), (pu), (pv), (pw), (px), (py), (pz), (qa), (qb), (qc), (qd), (qe), (qf), (qg), (qh), (qi), (qj), (qk), (ql), (qm), (qn), (qo), (qp), (qq), (qr), (qs), (qt), (qu), (qv), (qw), (qx), (qy), (qz), (ra), (rb), (rc), (rd), (re), (rf), (rg), (rh), (ri), (rj), (rk), (rl), (rm), (rn), (ro), (rp), (rq), (rr), (rs), (rt), (ru), (rv), (rw), (rx), (ry), (rz), (sa), (sb), (sc), (sd), (se), (sf), (sg), (sh), (si), (sj), (sk), (sl), (sm), (sn), (so), (sp), (sq), (sr), (ss), (st), (su), (sv), (sw), (sx), (sy), (sz), (ta), (tb), (tc), (td), (te), (tf), (tg), (th), (ti), (tj), (tk), (tl), (tm), (tn), (to), (tp), (tq), (tr), (ts), (tt), (tu), (tv), (tw), (tx), (ty), (tz), (ua), (ub), (uc), (ud), (ue), (uf), (ug), (uh), (ui), (uj), (uk), (ul), (um), (un), (uo), (up), (uq), (ur), (us), (ut), (uu), (uv), (uw), (ux), (uy), (uz), (va), (vb), (vc), (vd), (ve), (vf), (vg), (vh), (vi), (vj), (vk), (vl), (vm), (vn), (vo), (vp), (vq), (vr), (vs), (vt), (vu), (vv), (vw), (vx), (vy), (vz), (wa), (wb), (wc), (wd), (we), (wf), (wg), (wh), (wi), (wj), (wk), (wl), (wm), (wn), (wo), (wp), (wq), (wr), (ws), (wt), (wu), (wv), (ww), (wx), (wy), (wz), (xa), (xb), (xc), (xd), (xe), (xf), (xg), (xh), (xi), (xj), (xk), (xl), (xm), (xn), (xo), (xp), (xq), (xr), (xs), (xt), (xu), (xv), (xw), (xx), (xy), (xz), (ya), (yb), (yc), (yd), (ye), (yf), (yg), (yh), 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