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

EE–20–95, page 15.
Proposed regulations under section 125 of the Code relating to the effect of the Family and Medical Leave Act of 1993 on the operation of cafeteria plans.

EE–35–95, page 19.
Proposed regulations under section 411 of the Code provide guidance on calculation of an employee's accrued benefit derived from the employee's contributions to a qualified defined benefit pension plan.

EE–53–95, page 23.
Proposed regulations clarifying certain requirements for tax-exempt section 501(c)(5) organizations.

T.D. 8638, page 5.
INTL–9–95, page 24.
Temporary and proposed regulations under section 367 of the Code relating to certain transfers of domestic stock or securities by U.S. persons to foreign corporations. A public hearing will be held on April 11, 1996.

EXEMPT ORGANIZATIONS

Announcement 96–6, page 43.
A list is given of organizations now classified as private foundations.

Announcement 96–7, page 44.
A list is provided of organizations that no longer qualify as organizations to which contributions are deductible under section 170 of the Code.

EXCISE TAXES

T.D. 8639, page 12.
Final regulations under section 4941 of the Code that clarify the definition of self-dealing for private foundations.

ADMINISTRATIVE

Notice 96–6, page 27.
Closing of study project and moving of related no-rule provisions. The IRS and the Treasury Department have decided not to issue guidance at this time regarding corporate combining transactions and are closing the study project. In Rev. Proc. 96–22, this Bulletin, page 27, Rev. Proc. 96–3 is amplified and modified by moving the provision in section 5.15 from section 5 (Areas Under Extensive Study) to section 3 (Areas In Which Rulings or Determination Letters Will Not Be Issued).

Rev. Proc. 96–22, page 27.
Areas in which advance rulings will not be issued (Associate Chief Counsel (Domestic)). The No-Rule provision with respect to ''Combining Transactions'' presently in section 5.15 of Rev. Proc. 96–3, 1996–1 I.R.B. 82, is moved from section 5 (Areas Under Extensive Study) to section 3 (Areas In Which Rulings or Determination Letters Will Not Be Issued). Rev. Proc. 96–3 amplified and modified. *See* Notice 96–6, this Bulletin, page 27, regarding the closing of the study project.

(Continued on page 4)

Finding Lists begin on page 46.
Announcement of Declaratory Judgment Proceeding Under Section 7428 on page 44.

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 semiannually 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 Miscellanous.

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 Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provides (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) indexes of Public Laws, Treasury Decisions, and Tax Conventions.

HIGHLIGHTS OF THIS ISSUE—Continued

ADMINISTRATIVE—Continued

Rev. Proc. 96–23, page 27.

Domestic asset/liability and investment yield percentages. This procedure provides the domestic asset/liability percentages and domestic investment yield percentages for taxable years beginning after December 31, 1994, for foreign companies doing insurance business in the U.S. The percentages are necessary for computation of the minimum effectively connected income under section 842(b) for foreign companies conducting insurance business for taxable years beginning after December 31, 1994.

Rev. Proc. 96–24, page 28.

General rules and specifications for private printing of Forms W–2 and W–3. Specifications are set forth for the private printing of paper substitutes for tax year 1995 Form W–2, Wage and Tax Statement, and Form W–3, Transmittal of Wage and Tax Statements. Rev. Prov. 95–20 superseded.

Section 367.—Foreign Corporations

26 CFR 1.367(a)–3T: Treatment of transfers of stock or securities to foreign corporations (temporary).

T.D. 8638

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

Certain Transfers of Domestic Stock or Securities by U.S. Persons to Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: These temporary regulations provide the public with guidance necessary to comply with the Tax Reform Act of 1984. These regulations amend the Income Tax Regulations with respect to certain transfers of stock or securities of domestic corporations by United States persons to foreign corporations pursuant to the corporate organization, reorganization, or liquidation provisions of the Internal Revenue Code. This Treasury decision also removes certain of the existing temporary regulations regarding transfers by U.S. persons of stock or securities of both domestic and foreign corporations. This action is necessary to update the existing temporary regulations and to reflect certain of the changes announced by Notice 87–85 (1987–2 C.B. 395) (with respect to transfers of both domestic and foreign stock or securities) and by Notice 94–46 (1994–1 C.B. 356) (with respect to transfers of stock or securities of a domestic corporation). The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject *** [INTL–9–95, page 24, this Bulletin]. When finalized, the regulations under section 367(a) relating to the transfer of stock or securities will integrate the regulations herein with the 1991 proposed regulations relating to transfers of stock or securities (see Proposed Rule §§ 1.367(a)–3 and 1.367(a)–8, published at 56 FR 41993, August 26, 1991).

EFFECTIVE DATE: April 17, 1994. For further information, see the Applicability and Effective Dates section under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Philip L. Tretiak at (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Applicability and Effective Dates

These regulations are generally applicable to transfers occurring after April 17, 1994, the effective date of Notice 94–46. However, the active trade or business requirement (described in §1.367(a)–3T(c)(1)(iii) of the temporary regulations herein), which was not contained in Notice 94–46, is effective for transfers occurring after January 25, 1996. Moreover, these regulations remove as ''deadwood'' paragraphs (c)(1) through (c)(4), (d), (e), (f), (g)(1)(iii) and (h)(1) of §1.367(a)–3T of the existing temporary regulations with respect to transfers occurring after December 16, 1987, the effective date of Notice 87–85.

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure 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 under control number 1545–1478. Responses to this collection of information are required in order for U.S. shareholders that transfer stock or securities in section 367(a) exchanges to qualify for an exception to the general rule of taxation under section 367(a)(1).

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 this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in *** [INTL–9–95, page 24, this Bulletin].

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

On May 16, 1986, temporary and proposed regulations under sections 367(a) and (d) and section 6038B were published in the Federal Register (51 FR 17936). These regulations were published to provide the public with guidance necessary to comply with changes made to the Internal Revenue Code by the Tax Reform Act of 1984. Included in the 1986 temporary regulations was §1.367(a)–3T, concerning transfers of stock or securities of domestic or foreign corporations by U.S. persons to foreign corporations. Subsequently, the IRS and the Treasury Department issued Notice 87–85 (1987–2 C.B. 395), which set forth substantial changes to be made to §1.367(a)–3T, effective with respect to transfers occurring after December 16, 1987. A further notice of proposed rulemaking, containing rules under section 367(a), as well as under section 367(b), was published in the Federal Reister on August 26, 1991 (56 FR 41993). The 1991 proposed section 367(a) regulations were generally based upon the positions announced in Notice 87–85, but the regulations made certain modifications to Notice 87–85, particularly with respect to transfers of stock or securities of foreign corporations.

Most recently, the IRS and the Treasury Department issued Notice 94–46 (1994–1 C.B. 356), announcing modifications to the positions set forth in Notice 87–85 (and the 1991 proposed regulations) with respect to transfers of stock or securities of domestic corporations occurring after April 17, 1994. The temporary regulations set forth herein generally incorporate the modifications announced in Notice 94–46. The notice of proposed

rulemaking on this subject in *** [INTL–9–95, this Bulletin] supplements and, where inconsistent with, supersedes, the 1991 proposed regulations with respect to transfers of domestic stock or securities occurring after April 17, 1994.

Notice 94–46 announced that the regulations under section 367(a) would be amended to deny nonrecognition treatment to the transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation if all U.S. transferors owned in the aggregate 50 percent or more of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the exchange. (Under the approach taken in Notice 87–85, transfers of domestic stock or securities occurring prior to April 18, 1994 (and after December 16, 1987) were generally denied nonrecognition treatment only in the case of a single U.S. transferor that owned more than 50 percent of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer or of a U.S. transferor that held at least 5 percent (but no more than 50 percent) of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer and that failed to enter into a gain recognition agreement.)

In Notice 94–46, the IRS and the Treasury Department invited comments on possible exceptions to the general rule set forth in the Notice, specifically with respect to cases where (i) a domestic corporation is acquired by a foreign corporation that is engaged in an active trade or business and that, prior to the transaction, is unrelated to the acquired corporation or its shareholders, or (ii) the transferee foreign corporation is a controlled foreign corporation (within the meaning of section 957) after the transfer. After consideration of the comments received, the IRS and the Treasury Department have concluded that no exceptions to the general rule are warranted.

In the Notice, the IRS and the Treasury Department also invited specific comment on whether special rules should be provided to determine the ownership of the transferee foreign corporation in cases where the corporation is publicly traded. As described below, in response to comments received, the ''cross-ownership'' rules of Notice 94–46 have been modified in a way that will ameliorate the burdens of identifying shareholders of publicly traded (or widely-held) corporations and that should reduce the impact of the general rule on business combinations involving unrelated U.S. and foreign corporations that are engaged in the active conduct of a trade or business.

Need for Temporary Regulations

The rules contained in this Treasury decision provide taxpayers with guidance necessary to comply with Notice 94–46, which was effective with respect to transfers of stock or securities of domestic corporations to foreign corporations occurring after April 17, 1994. The provisions of Notice 94–46 were made immediately effective to forestall certain tax-avoidance transfers by U.S. persons of the stock of U.S.-based multinationals to foreign corporations. Because of the Notice's immediate effective date, there is a need for implementing regulations on which both taxpayers and the Service may rely with respect to current transfers. Based on these considerations, it is determined that immediate regulatory guidance will ensure the efficient administration of the tax laws and that it would be impracticable and contrary to the public interest to issue this Treasury decision with prior notice under section 553(b) or subject to the effective date limitation of section 553(d) of title 5 of the United States Code.

Explanation of Provisions

Section 367(a)(1) generally treats a transfer of property (including stock or securities) by a U.S. person to a foreign corporation in connection with an exchange described in section 332, 351, 354, 356 or 361 as a taxable exchange unless the transfer qualifies for an exception to this general rule. Temporary regulations published on May, 16, 1986 (TD 8087) provided exceptions in the case of certain transfers of stock or securities of domestic and foreign corporations (see §1.367(a)–3T). Notice 87–85 announced modifications to those exceptions for transfers of domestic or foreign stock or securities occurring after December 16, 1987. Proposed regulations issued on August 26, 1991 largely incorporated the positions set forth in Notice 87–85, and expanded the application of section 367(a) with respect to certain transfers of stock or securities of foreign corporations. Notice 94–46 announced modifications to the exceptions originally announced in Notice 87–85, effective with respect to certain transfers of stock or securities of domestic corporations occurring after April 17, 1994.

Both the temporary regulations herein and the notice of proposed rulemaking on this subject in *** [INTL–9–95, this Bulletin] generally incorporate the positions taken in Notice 94–46, with modifications as described below. As indicated previously, Notice 94–46 did not modify the positions taken in Notice 87–85 governing the transfer of stock or securities of a foreign corporation. Until the 1991 proposed regulations are finalized, the positions originally announced in Notice 87–85 will continue to govern the availability of section 367(a) exceptions for transfers of stock or securities of foreign corporations.

In addition to implementing the positions announced in Notice 94–46, this Treasury decision removes those portions of §1.367(a)–3T of the 1986 temporary regulations that Notice 87–85 announced would no longer be applicable with respect to stock transfers occurring after December 16, 1987. This includes removal of the exceptions in paragraphs (c)(1) through (4) (providing exceptions for certain transfers of domestic stock or securities); of paragraph (d) (providing exceptions for certain transfers of foreign stock or securities, including an exception for transfers to a foreign corporation organized in the same foreign country as the corporation the stock of which is being transferred); of paragraph (e) (involving exceptions where stock is an operating asset or where there is a consolidation of an integrated business); and of paragraph (f) (exceptions where U.S. transferors obtain a limited interest in the transferee foreign corporation).

The temporary regulations herein also incorporate (in paragraph (a)) the 1991 proposed regulations' restatement of the general rule applicable to outbound stock transfers (see Prop. Reg. §1.367(a)–3(a)). This restatement revises the general rule contained in the 1986 temporary regulations to reflect changes to section 367 made by Congress after promulgation of those regulations. For example, the 1986 tempo-

rary regulations' statement of the general rule included transfers of stock or securities in section 332 liquidations as one of the transactions covered by section 367(a) (see §1.367(a)–3T(a)). The restatement of the general rule in the temporary regulations herein removes the reference to section 332 because an outbound transfer of stock or securities pursuant to a section 332 liquidation is now covered by section 367(e)(2) and the regulations under §1.367(e)–2T. Even though the temporary regulations under §1.367(e)–2T have sunset (because they were promulgated as temporary regulations on January 12, 1990 (TD 8280) and were not finalized within three years of that date), the Service announced its intention to follow the principles of those regulations in the preamble to the final regulations under section 367(e)(1) (see the preamble to the final section 367(e)(1) regulations in TD 8472, adopted January 15, 1993).

The revised statement of the general rule herein refers explicitly to transfers that may be indirect or constructive. Thus, transactions that are recharacterized as indirect or constructive stock transfers will be subject to the section 367(a) stock transfer regulations and will be taxable unless an exception applies.

The restatement of the general rule herein is not intended to change the 1986 temporary regulations' treatment of a case in which stock or securities of a foreign corporation are transferred pursuant to a reorganization described in section 368(a)(1)(B), including a transaction that is described in both section 368(a)(1)(B) and section 351. It is anticipated, however, that the final regulations issued with respect to an outbound transfer of foreign stock or securities will incorporate the principles of the 1991 proposed regulations, and thus, for example, a transaction described in both section 368(a)(1)(B) and section 351 will be subject to section 367(a).

Notice 87–85 and the 1991 Proposed Regulations

Under Notice 87–85 and the 1991 proposed regulations, a U.S. transferor of stock or securities that owns five percent or more of either the total voting power or the total value of the transferee foreign corporation immediately after the transfer generally is not subject to current taxation under section 367(a)(1) if that transferor enters into a gain recognition agreement (GRA). The term of the GRA is five years if all U.S. transferors, in the aggregate, own less than 50 percent of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer, or ten years if the U.S. transferors, in the aggregate, own 50 percent or more of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer. U.S. transferors that own an interest of less than 5 percent in the transferee foreign corporation immediately after the transfer are not taxable under section 367(a)(1) and are not required to enter into a GRA. If a single U.S. transferor transfers stock or securities of a domestic corporation and owns directly or by attribution more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer, gain is recognized on the exchange.

The determination whether (i) a U.S. transferor owns five percent or more of the transferee foreign corporation immediately after the transfer, (ii) U.S. transferors own in the aggregate 50 percent or more of the transferee foreign corporation (and, thus, whether a 10-year GRA is required), or (iii) a single U.S. transferor owns more than 50 percent of the transferee foreign corporation (and, thus, whether gain is recognized) takes into account both stock of the transferee foreign corporation received by the U.S. transferor(s) in the exchange and stock in the transferee foreign corporation owned by the U.S. transferor(s) independent of the exchange (referred to as cross-ownership).

Notice 87–85 and the 1991 proposed regulations presume that U.S. transferors own in the aggregate 50 percent or more of the total voting power or the total value of the transferee foreign corporation immediately after the transfer (and thus a ten-year GRA is required), unless U.S. transferors can demonstrate otherwise (referred to as the ownership presumption). The ownership presumption contained in both the Notice and the 1991 proposed regulations actually consists of two rebuttable presumptions, one relating to ownership of stock in the U.S. corporation the stock or securities of which are transferred (referred to as the U.S. target company) and the other relating to ownership of stock in the transferee foreign corporation.

Under the first presumption, all persons that exchange U.S. target company stock (or other property) for stock of the transferee foreign corporation in the exchange are presumed to be U.S. persons. Thus, if shareholders of the U.S. target company receive 50 percent or more of the stock of the transferee foreign corporation in the exchange, U.S. transferors are presumed to own 50 percent or more of the stock of the transferee foreign corporation immediately after the transfer. Even if application of this first presumption does not result in U.S. transferors being deemed to own at least 50 percent of the total voting power or the total value of the transferee foreign corporation immediately after the transfer, the second presumption may do so. The second presumption is that U.S. transferors also own stock of the transferee foreign corporation independent of the exchange in an amount sufficient to bring their total ownership immediately after the exchange up to 50 percent. This second component of the ownership presumption is referred to as the cross-ownership presumption.

Notice 94–46

Notice 94–46 modified the exceptions set forth in Notice 87–85 with respect to post-April 17, 1994 transfers of stock or securities of domestic corporations. The purpose of Notice 94–46 was to forestall outbound transfers that are structured to avoid or that lay a foundation for future avoidance of the Internal Revenue Code anti-deferral regimes by imposing a shareholder-level tax on such transfers. Notice 94–46 stated that regulations would provide that the transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation described in section 367(a) would be taxable if all U.S. transferors owned, in the aggregate, 50 percent or more of either the total voting power or the total value of the stock of the transferee corporation immediately after the exchange. All U.S. transferors, regardless of their level of ownership, would be subject to tax in such a case.

The rules of Notice 94–46 incorporated the ownership presumption of Notice 87–85. As a result of the cross-

ownership aspect of that presumption, even if U.S. shareholders receive significantly less than 50 percent of the stock of a transferee foreign corporation in an exchange described in section 367(a), the transaction could still be taxable. If, for example, U.S. shareholders of a U.S. target company received 30 percent of the stock of a transferee foreign corporation in an exchange described in section 367(a)(1), those shareholders would be presumed to own independently at least an additional 20 percent of the stock of the transferee foreign corporation immediately after the transfer, with the result that the exchange would be taxable (unless the cross-ownership presumption were rebutted). Commentators argued that where a U.S. target company and a foreign acquirer were publicly traded or widely-held, taxpayers' ability to rebut the cross-ownership aspect of the ownership presumption was limited. As a result, Notice 94–46 potentially had the effect of forestalling acquisitions of U.S. public companies by larger foreign corporations in cases where they were unrelated and both engaged in the active conduct of a trade or business.

In response to comments received from taxpayers, and in particular with respect to the difficulties of rebutting the cross-ownership presumption, these temporary regulations modify positions taken in Notice 94–46 in two significant ways. First, the regulations shift the ownership threshold from ''50 percent or more'' to ''more than 50 percent'' so that a U.S. transferor may qualify for an exception to section 367(a) in cases where U.S. transferors, in the aggregate, receive exactly 50 percent of the stock of the transferee foreign corporation in the exchange. The relaxation of the ownership threshold was intended to give 50-50 joint ventures involving unrelated U.S. and foreign corporations that are engaged in active businesses the option of using a foreign transferee corporation. Where a foreign corporation is smaller than a U.S. corporation that it acquires, the transaction will still generally be taxable; it would not be taxable if the U.S. participant were the acquiring corporation in the transaction (or if another U.S. holding company were the acquiring corporation). Second, although the regulation retains the presumption that shareholders of the U.S. target company are U.S. persons, it does not, in general, retain the cross-ownership presumption and no longer, as a general matter, takes cross-ownership into account. The regulation counts cross-ownership only in the limited circumstance where U.S. officers, directors, and 5-percent or greater shareholders of the U.S. target company own, in the aggregate, more than 50 percent of the total voting power or the total value of the transferee foreign corporation immediately after the transfer (a control group case). In such a case, the exchange is taxable to all U.S. transferors. The regulation allows taxpayers to rely on Schedule 13–D or 13–G filings made under the Securities Exchange Act of 1934 (15 USC 78m) to identify 5-percent shareholders of public companies for this purpose.

Although cross-ownership does not count toward the 50 percent ownership threshold (unless the control group case applies), it is still relevant in determining whether a U.S. transferor owns five percent or more of the transferee foreign corporation under the rules originally announced in Notice 87–85. Moreover, cross-ownership continues to be relevant for determining whether a 5-year or 10-year GRA is required under the rules originally announced in 87–85, and, for these purposes, there continues to be a rebuttable presumption.

In addition to the two modifications described above that were made in response to comments received with respect to Notice 94–46, these regulations contain a new active trade or business requirement not contained in Notice 94–46, which taxpayers must meet in order to qualify for an exception to the general rule of taxation under section 367(a). The IRS and the Treasury Department added the active trade or business requirement to address abuse potential, in particular, in a case in which a U.S. target company is smaller than a foreign acquirer that was formed and capitalized with a view to enabling the smaller U.S. company to move offshore. The IRS and the Treasury Department believe that this type of transaction presents an inappropriate opportunity for avoiding the anti-deferral regime without payment of the tax envisioned by Notice 94–46. The IRS and the Treasury Department believe that an exception to taxation is proper only in cases where a combination of two active businesses is contemplated and that the opportunity for tax avoidance is ameliorated when such businesses have been conducted for a period of at least 36 months prior to the exchange. Under the requirement contained in the regulations, no exception to taxation is available unless either the transferee foreign corporation or an affiliate of that corporation was engaged in the active conduct of a trade or business for the entire 36-month period prior to the exchange, and unless such business is substantial in relation to the business conducted by the U.S. target company. For this purpose, an affiliate is generally defined by reference to the rules in section 1504(a) (without the exclusion of foreign corporations), and generally includes a parent, subsidiary or brother-sister corporation of the transferee foreign corporation.

To summarize, under the temporary regulations, a U.S. person that exchanges stock or securities in a U.S. corporation for stock of a foreign corporation in an exchange described in section 367(a) will be taxable in cases where:

(i) the 50 percent ownership threshold is exceeded;

(ii) the control group case applies;

(iii) the active trade or business requirement is not met; or

(iv) the exchanging U.S. shareholder owns five percent or more of the stock of the transferee foreign corporation and fails to enter into a GRA and/or satisfy the requirements of section 6038B.

The duration of the GRA in case (iv) is 5 years if the transferor can demonstrate that all U.S. transferors in the aggregate own less than 50 percent of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer or 10 years if U.S. transferors own exactly 50 percent (or more than 50 percent as a result of cross-ownership) of the transferee foreign corporation immediately after the transfer. In all cases other than those enumerated in (i) through (iv) above, a U.S. person that transfers stock or securities of a domestic corporation in exchange for stock of a transferee foreign corporation will not be taxable under section 367(a) if certain reporting requirements described in the regulations are met.

Final regulations under section 367(a) are expected to address the transfer of stock or securities of foreign corporations and other matters contained in the 1991 proposed regulations that are not addressed herein.

Special Analyses

It has been determined that this temporary regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that this regulation does not have a significant impact on a substantial number of small entities. Thus, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, a copy of 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 Philip L. Tretiak of the Office of Associate Chief Counsel (International), within the Office of Chief Counsel, Internal Revenue Service. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

Part 1—INCOME TAXES

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

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

Par. 2. Section 1.367(a)–3T is amended by revising paragraphs (a), (c), (d), (e), (f), (g)(1) and (h)(1) to read as follows:

§1.367(a)–3T Treatment of transfers of stock or securities to foreign corporations (temporary).

(a) *In general.* This section provides rules concerning the transfer of stock or securities by a U.S. person to a foreign corporation in an exchange described in section 367(a). In general, a transfer of stock or securities by a U.S. person (directly, indirectly or constructively) to a foreign corporation that is described in section 351, 354 (pursuant to a reorganization described in section 368(a)(1)(B)) or section 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless one of the exceptions set forth in paragraph (b), (c) or (d) of this section applies. For additional rules relating to an exchange involving a foreign corporation in connection with which there is a transfer of stock, see section 367(b) and the regulations under that section. For additional rules regarding a transfer of stock or securities in an exchange described in section 361(a) or (b), see section 367(a)(5) and any regulations under that section.

* * * * * *

(c) *Transfers by U.S. persons of stock or securities of domestic corporations to foreign corporations*—(1) *In general.* Except as provided in section 367(a)(5), a transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section shall not be subject to section 367(a)(1) if the domestic corporation the stock or securities of which are transferred (referred to as the U.S. target company) complies with the reporting requirements in paragraph (c)(4) of this section and if each of the following four conditions is met:

(i) Fifty percent or less of both the total voting power and the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by U.S. transferors (*i.e.*, the amount of stock received does not exceed the 50 percent threshold).

(ii) No more than 50 percent of each of the total voting power and the total value of the stock of the transferee foreign corporation is owned, in the aggregate, immediately after the transfer by U.S. persons who are either officers or directors of the U.S. target company or who are five-percent target shareholders (as defined in paragraph (c)(6)(iii) of this section) (*i.e.*, there is no control group). For purposes of this paragraph (c)(1)(ii), any stock of the transferee foreign corporation owned by U.S. persons immediately after the transfer will be taken into account, whether or not it was received in the exchange for stock or securities of the U.S. target company.

(iii) In the case of a transfer occurring after January 25, 1996, the transferee foreign corporation or an affiliate of the transferee foreign corporation has been engaged in the active conduct of a trade or business, within the meaning of §1.367(a)–2T(b)(2) and (3), that is substantial in comparison to the trade or business of the U.S. target company, for the entire 36-month period immediately preceding the date of the transfer.

(iv) Either—

(A) The U.S. person is not a five-percent transferee shareholder (as defined in paragraph (c)(6)(ii) of this section); or

(B) The U.S. person is a five-percent transferee shareholder and enters into an agreement to recognize gain with respect to the U.S. target company stock or securities it exchanged in the form provided in paragraph (g) of this section, as modified by paragraph (c)(3) of this section (setting the duration of the gain recognition agreement).

(2) *Ownership Presumption.* For purposes of paragraph (c)(1) of this section, persons who transfer stock or securities of the U.S. target company or other property in exchange for stock of the transferee foreign corporation are presumed to be U.S. persons. This presumption may be rebutted in accordance with paragraph (c)(4)(ii) of this section.

(3) *Term of the gain recognition agreement.* If, immediately after the transfer described in section 367(a)(1), all U.S. transferors own in the aggregate less than fifty percent of both the total voting power and the total value of the stock of the transferee foreign corporation (counting both stock of the transferee foreign corporation owned as a result of the exchange as well as stock of the transferee foreign corporation owned independently by such U.S. transferors), the agreement to recognize gain shall be in the form specified in paragraph (g)(3) of this section. The term of the agreement shall be ten years, rather than the five years specified in paragraph (g)(3) of this section, the waiver described in paragraph (g)(4) of this section shall extend the period for assessment of tax for an additional five years, and the certification and waiver described in paragraph (g)(5) of this section must be filed for an additional five years if—

(i) The five-percent transferee shareholder cannot determine whether the

condition in the preceding sentence is satisfied; or

(ii) Immediately after the transfer, all U.S. transferors own in the aggregate fifty percent or more of either the total voting power or the total value of the stock of the transferee foreign corporation (counting both stock of the transferee foreign corporation owned as a result of the exchange, as well as stock of the transferee foreign corporation owned independently by such U.S. transferors).

(4) *Reporting requirements of U.S. target company*. (i) In order for a U.S. person that transfers stock or securities of a domestic corporation to qualify for the exception to the general rule under section 367(a)(1) provided by this paragraph (c), the U.S. target company must comply with the reporting requirements contained in this paragraph (c)(4). The U.S. target company must attach to its timely filed U.S. income tax return (or a subsequent, timely filed amended return) for the taxable year in which the transfer occurs a statement titled ''Section 367(a)—Reporting of Cross-Border Transfer Under Reg. §1.367(a)–3T(c)(4),'' signed under penalties of perjury by an officer of the corporation, disclosing the following information—

(A) A description of the transaction in which a U.S. person or persons transferred stock or securities in the U.S. target company to the transferee foreign corporation in a transfer otherwise subject to section 367(a)(1);

(B) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company or other property. For additional information that may be required to rebut the ownership presumption of paragraph (c)(2) of this section in cases where more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company or other property, see paragraph (c)(4)(ii) of this section;

(C) The amount (if any) of transferee foreign corporation stock owned directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)) immediately after the exchange by the U.S. target company;

(D) A statement that there is no control group within the meaning of paragraph (c)(1)(ii) of this section;

(E) A list of U.S. persons who are officers, directors or five-percent target shareholders and the percentage of the total voting power and the total value of the stock of the transferee foreign corporation owned by such persons both immediately before and immediately after the transaction; and

(F) A statement that the active trade or business test described in paragraph (c)(1)(iii) of this section is satisfied by the transferee foreign corporation or an affiliate and a description of such business.

(ii) To rebut the ownership presumption of paragraph (c)(2) of this section, the U.S. target company must obtain ownership statements (described in paragraph (c)(6)(i) of this section) from a sufficient number of persons that transfer U.S. target company stock or securities (or other property) in the transaction that are not U.S. persons to demonstrate that the 50 percent threshold is not exceeded. In addition, the U.S. target company must attach to its timely filed U.S. income tax return (or a subsequent, timely filed amended return) for the taxable year in which the transfer occurs a statement, titled ''Section 367(a)—Compilation of Ownership Statements under Reg. §1.367(a)–3T(c),'' signed under penalties of perjury by an officer of the corporation, disclosing the following information:

(A) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received, in the aggregate, by U.S. transferors;

(B) The amount (specified as to the percentage of total voting power and total value) of stock of the transferee foreign corporation received, in the aggregate, by foreign persons that filed ownership statements;

(C) A summary of the information tabulated from the ownership statements, including—

(*1*) The names of the persons that filed ownership statements stating that they are not U.S. persons;

(*2*) The countries of residence and citizenship of such persons; and

(*3*) The ownership of such persons (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such persons in the exchange.

(iii) For purposes of paragraph (c)(4), an income tax return (including an amended return) will be considered timely filed if it is filed prior to the time that the Internal Revenue Service discovers that the reporting requirements of this paragraph have not been satisfied.

(5) *Special Rules*—(i) *Treatment of partnerships*. For purposes of paragraph (c), if a partnership (whether domestic or foreign) owns or transfers stock or securities or other property in an exchange described in section 367(a), each partner in the partnership, and not the partnership itself, is treated as owning and as having transferred a proportionate share of the stock or securities or other property. See §1.367(a)–1T(c)(3).

(ii) *Treatment of options*. For purposes of paragraph (c) of this section, one or more options (or an interest similar to an option) will be treated as exercised and thus will be counted as stock for purposes of determining whether the 50 percent threshold is exceeded or whether a control group exists if a principal purpose of the issuance or the acquisition of the option (or other interest) was the avoidance of the general rule contained in section 367(a).

(iii) *U.S. target has a vestigial ownership interest in transferee foreign corporation*. In cases where, immediately after the transfer, the U.S. target company owns, directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)) stock of the transferee foreign corporation, that stock will not in any way be taken into account (and, thus, will not be treated as outstanding) in determining whether the 50 percent threshold under paragraph (c)(1)(i) of this section is exceeded or whether a control group under paragraph (c)(1)(ii) of this section exists.

(iv) *Attribution rule*. The rules of section 958 shall apply for purposes of determining the ownership of stock, securities or other property under this paragraph (c).

(6) *Definitions*—(i) *Ownership statement*. An ownership statement is a statement, signed under penalties of perjury, stating—

(A) The identity and taxpayer identification number, if any, of the person making the statement;

(B) That the person making the statement is not a U.S. person (as defined in paragraph (c)(6)(iv) of this section);

(C) That the person making the statement is not related to any U.S. person to whom the stock or securities owned by the person making the statement are attributable under the rules of section 958, or, if stock or securities are so attributable, the identity and taxpayer identification number of the relevant U.S. person;

(D) The citizenship, permanent residence, home address, and U.S. address, if any, of the person making the statement; and

(E) The ownership such person has (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such person in the exchange.

(ii) *Five-percent transferee shareholder*. A five-percent transferee shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer described in section 367(a)(1). For special rules involving cases in which stock is held by a partnership, see paragraph (c)(5)(i) of this section.

(iii) *Five-percent target shareholder*. A five-percent target shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the U.S. target company immediately prior to the transfer described in section 367(a)(1). If the stock of the U.S. target company is described in Rule 13d–1(d) of Regulation 13D (17 CFR 240.13d–1(d)) (or any rule or regulation to generally the same effect), promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 USC 78m), the existence or absence of filings of Schedule 13–D or 13–G (or any similar schedules) may be relied upon for purposes of identifying five-percent target shareholders. For special rules involving cases in which U.S. target company stock is held by a partnership, see paragraph (c)(5)(i) of this section.

(iv) *U.S. Person*. For purposes of this section, a U.S. person is defined by reference to §1.367(a)–1T(d)(1). For application of the rules of this section to stock or securities owned or transferred by a partnership that is a U.S. person, however, see paragraph (c)(5)-(i) of this section.

(v) *U.S. Transferor*. A U.S. transferor is a U.S. person (as defined in paragraph (c)(6)(iv) of this section) who transfers directly, indirectly or constructively stock or securities of the U.S. target company or other property in exchange for stock of the transferee foreign corporation in an exchange described in section 367.

(vi) *Transferee foreign corporation*. A transferee foreign corporation is the foreign corporation whose stock is received in the exchange by U.S. persons.

(vii) *Affiliate*. An affiliate is a corporation that is a member of the same affiliated group (as defined in section 1504(a), without regard to section 1504(b)(3)) as the transferee foreign corporation.

(7) *Certain transfers in connection with performance of services*. Section 367(a)(1) shall not apply to a domestic corporation's transfer of its own stock or securities in connection with the performance of services, if the transfer is considered to be to a foreign corporation solely by reason of §1.83–6(d)(1).

(8) *Examples*. This paragraph (c) may be illustrated by the following examples:

Example 1. Ownership presumption. (i) FC, a foreign corporation, issues 51 percent of its stock to the shareholders of S, a domestic corporation, in exchange for their S stock, in a transaction described in section 367(a)(1).

(ii) Under paragraph (c)(2) of this section, all shareholders of S who receive stock of FC in the exchange are presumed to be U.S. persons. Unless this ownership presumption is rebutted, the condition set forth in paragraph (c)(1)(i) of this section will not be satisfied, and the exception in paragraph (c)(1) of this section will not be available. As a result, all U.S. persons that transferred S stock will recognize gain on the exchange. To rebut the ownership presumption, S must comply with the reporting requirements contained in paragraph (c)(4)(ii) of this section, obtaining ownership statements (described in paragraph (c)(6)(i) of this section) from a sufficient number of non-U.S. persons who received FC stock in the exchange to demonstrate that the amount of FC stock received by U.S. persons in the exchange does not exceed 50 percent.

Example 2. Filing of Gain Recognition Agreement. (i) The facts are the same as in *Example 1*, except that FC issues only 40 percent of its stock to the shareholders of S in the exchange. FC satisfies the active trade or business test (described in paragraph (c)(1)(iii) of this section). A, a U.S. person, owns 10 percent of S's stock immediately before the transfer. All other shareholders of S own less than five percent of its stock. None of S's officers or directors owns any stock in FC immediately after the transfer. A will own 15 percent of the stock of FC immediately after the transfer, 4 percent received in the exchange, and the balance being stock in FC that A owned prior to and independent of the transaction. No S shareholder besides A owns five percent or more of FC immediately after the transfer. The reporting requirements under paragraph (c)(4)(i) of this section are satisfied.

(ii) The condition set forth in paragraph (c)(1)(i) of this section is satisfied because, even after application of the presumption in paragraph (c)(2) of this section, U.S. transferors could not receive more than 50 percent of FC's stock in the transaction. There is no control group because five-percent target shareholders and officers and directors of S do not, in the aggregate, own more than 50 percent of the stock of FC immediately after the transfer (A, the sole five-percent target shareholder, owns 15 percent of the stock of FC immediately after the transfer, and no officers or directors of S own any stock of FC immediately after the transfer). Therefore, the condition set forth in paragraph (c)(1)(ii) of this section is satisfied (and A's cross-ownership of FC stock is not taken into account). The facts assume that the condition set forth in paragraph (c)(1)(iii) of this section is satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, a five-percent transferee shareholder, will not be required to include in income any gain realized on the exchange in the year of the transfer if he files a gain recognition agreement (GRA) and complies with section 6038B. The duration of the GRA is five years if all U.S. transferors own in the aggregate less than 50 percent of the total voting power and the total value of FC immediately after the transfer, and ten years if this condition is not satisfied. If A lacks the information to determine whether he is eligible to file a five-year GRA (because the determination includes a cross-ownership inquiry for all U.S. transferors), he is required to file a ten-year GRA.

Example 3. Control Group. (i) The facts are the same as in *Example 2*, except that B, another U.S. person, is a 5-percent target shareholder, owning 25 percent of S's stock immediately before the transfer. B owns 40 percent of the stock of FC immediately after the transfer, 10 percent received in the exchange, and the balance being stock in FC that B owned prior to and independent of the transaction.

(ii) A control group exists because A and B, each a five-percent target shareholder within the meaning of paragraph (c)(6)(iii) of this section, together own more than 50 percent of FC immediately after the transfer (counting both stock received in the exchange and stock owned prior to and independent of the exchange). As a result, the condition set forth in paragraph (c)(1)(ii) of this section is not satisfied, and all U.S. persons (not merely A and B) who transferred S stock will recognize gain on the exchange.

Example 4. Partnerships. (i) The facts are the same as in *Example 3*, except that B is a partnership (domestic or foreign) that has five equal partners, only two of whom, X and Y, are U.S. persons. X and Y are treated as the owners and transferors of 5 percent each of the S stock owned and transferred by B and as owners of 8 percent each of the FC stock owned by B immediately after the transfer. Five-percent target shareholders thus own a total of 31 percent of the stock of FC immediately after the transfer (A's 15 percent, plus X's 8 percent, plus Y's 8 percent).

(ii) Because no control group exists, the condition in paragraph (c)(1)(ii) of this section is satisfied. The conditions in paragraphs (c)(1)(i) and (iii) of this section also are satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, X, and Y, each a five-percent transferee shareholder, will not be required to include in income in the year of the transfer any gain realized on the exchange if they file GRAs and comply with section 6038B. The duration of the GRA is five years if all U.S. transferors own in the aggregate less than 50 percent of the total voting power and the total value of FC immediately after the transfer, and ten years if this condition is not satisfied. If A, X, and Y lack the information to determine whether they are eligible to file five-year GRAs (because the determination includes a cross-ownership inquiry for all U.S. transferors), they are required to file ten-year GRAs.

(9) *Effective date.* This paragraph (c) applies to transfers occurring after April 17, 1994. However, paragraph (c)(1)(iii) of this section applies only to transfers occurring after January 25, 1996. For transfers occurring before December 17, 1987, see §1.367(a)–3T(c)(1) through (4) as contained in 26 CFR Part 1 revised April 1, 1995.

(d) *Transfers of stock or securities of foreign corporations.* For guidance, see Notice 87–85 (1987–2 C.B. 395). See §601.601(d)(2) of this chapter.

(e) [Reserved.] For transfers occurring before December 17, 1987, see §1.367(a)–3T(e) as contained in 26 CFR Part 1 revised April 1, 1995.

(f) [Reserved.] For transfers occurring before December 17, 1987, see §1.367(a)–3T(f) as contained in 26 CFR Part 1 revised April 1, 1995.

(g) *Transferor's agreement to recognize gain upon later disposition by transferee*—(1) *In general.* A transfer of stock or securities shall not be subject to section 367(a)(1) if—

(i) The transferor complies with the reporting requirements of section 6038B and any regulations thereunder; and

(ii) The transferor files a binding agreement to recognize gain upon the transferee corporation's later disposition of the transferred stock or securities, in accordance with the rules of this section.

* * * * * *

(h) *Anti-abuse rules.*

(1) [Reserved.] For transfers occurring before December 17, 1987, see §1.367(a)–3T(h)(1) as contained in 26 CFR Part 1 revised April 1, 1995.

* * * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority for citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805

Par. 4. In §602.101, paragraph (c) is amended by revising the entry in the table for ''1.367(a)–3T'' to read as follows:

''1.367(a)–3T 0026
. . . . . 1478''.

Dated: December 13, 1995.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved:

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 22, 1995, 8:45 a.m., and published in the issue of the Federal Register for December 26, 1995, 60 F.R. 66739)

Section 368.—Definitions relating to corporate reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

The No-Rule provision with respect to ''Combining Transactions'' presently in section 5.15 of Rev. Proc. 96–3, 1996–1 I.R.B. 82, is moved from section 5 (Areas Under Extensive Study) to section 3 (Areas In Which Rulings or Determination Letters Will Not Be Issued). Rev. Proc. 96–3 amplified and modified. *See also,* Notice 96–6, this Bulletin, regarding the closing of the study project. *See* Rev. Proc. 96–22, page 27.

Section 842.—Foreign Companies Carrying on Insurance Business

The domestic asset/liability percentages and domestic investment yields necessary for foreign companies doing insurance business in the U.S. to compute their minimum effectively connected net investment income under section 842(b) of the Code are provided for taxable years beginning after December 31, 1994. See Rev. Proc. 96–23, page 27.

Section 4941.—Taxes on Self-Dealing

26 CFR 53.4941(d)–2: Specific acts of self-dealing.

T.D. 8639

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 53

Excise Tax On Self-Dealing By Private Foundations.

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations that clarify the definition of self-dealing for private foundations. These regulations modify the application of the self-dealing rules to the provision by a private foundation of directors' and officers' liability insurance to disqualified persons. In general, these regulations provide that indemnification by a private foundation or provision of insurance for purposes of covering the liabilities of the person in his/her capacity as a manager of the private foundation is not self-dealing. Additionally, the amounts expended by the private foundation for insurance or indemnification generally are not included in the compensation of the disqualified person for purposes of determining whether the disqualified person's compensation is reasonable.

DATES: These regulations are effective December 20, 1995.

FOR FURTHER INFORMATION CONTACT: Terri Harris or Paul Accettura of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS, at 202-622-6070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 3, 1995 proposed regulations amending §53.4941(d)–2(f) [EE–56–94, 1995–1 C.B. 855] under section 4941 of the Internal Revenue Code of 1986 were published in the Federal Register (60 FR 82). The proposed regulations provided that generally it would not be self-dealing, nor treated as the payment of compensation, if a private foundation were to indemnify or provide insurance to a foundation manager in any civil judicial or civil

administrative proceeding arising out of the manager's performance of services on behalf of the foundation. After IRS and Treasury consideration of the public comments received regarding the proposed regulations, the regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Section 4941(a) imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Section 4941(d)(1)(E) defines self-dealing to include any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation. Prior to this Treasury decision, §53.4941(d)–2(f)(1) provided that provision of insurance for the payment of chapter 42 taxes by a private foundation for a foundation manager was self-dealing unless the premium amounts were included in the compensation of the foundation manager. The payment of chapter 42 taxes by the private foundation on behalf of the foundation manager was self-dealing whether or not the amounts were included in the manager's compensation.

Section 53.4941(d)–2(f)(3) provided that the indemnification of certain expenses by a private foundation for a foundation manager's defense in a judicial or administrative proceeding involving chapter 42 taxes was not self-dealing. Such expenses must have been reasonably incurred by the manager in connection with such proceeding. Also, the manager must have been successful in such defense, or such proceeding must have been terminated by settlement, and the manager must not have acted willfully and without reasonable cause with respect to the act or failure to act which led to the liability for tax under chapter 42.

This Treasury decision expands the scope of the regulations to cover indemnification and insurance payments made by a private foundation to or on behalf of a foundation manager in connection with any civil proceeding arising from the manager's performance of services for the private foundation. The regulations also clarify the distinction between the treatment of indemnification and insurance payments under chapter 42 and the treatment of these same items for income tax purposes.

The proposed regulations resulted in some confusion as to whether certain indemnification and insurance payments would be considered compensatory or non-compensatory. The final regulations have been revised to provide greater clarity. They divide indemnification payments and insurance coverage into non-compensatory and compensatory categories, described comprehensively in §53.4941(d)–2(f)(3) and (4). The second and third sentences of §53.4941(d)–2(f)(1) of the proposed regulations have been removed because their substance was incorporated into §53.4941(d)–2(f)(4). Generally, the non-compensatory category includes indemnification and insurance payments that cover expenses reasonably incurred in proceedings that do not result from a willful act or omission of the manager undertaken without reasonable cause. These payments are viewed as expenses for the foundation's administration and operation rather than compensation for the manager's services. The compensatory category includes indemnification or insurance payments that cover taxes (including taxes imposed by chapter 42), penalties or expenses of correction, expenses that were not reasonably incurred, or expenses for proceedings that result from a willful act or omission of the manager undertaken without reasonable cause. These payments are viewed as being exclusively for the benefit of the manager, not the foundation.

The regulations provide that non-compensatory indemnification and insurance payments are not affected by the prohibition against self-dealing. Conversely, compensatory indemnification and insurance payments are considered acts of self-dealing unless they are added to the benefiting manager's total compensation for purposes of determining whether that compensation is reasonable. If the total compensation is not reasonable, the foundation will have engaged in an act of self-dealing.

In some instances, a foundation may purchase an insurance policy that provides both non-compensatory and compensatory coverage. Some commentators have recommended that no allocation of insurance premiums be required when a single policy of this sort is purchased. These commentators argue that the allocation requirement places an undue burden on private foundations. After careful consideration, the IRS and the Treasury Department have decided to retain the allocation provision in the final regulations. The self-dealing rules were meant to discourage foundations from relieving managers of penalties, taxes and expenses of correction, as well as expenses ultimately resulting from the manager's willful violation of the law. A rule that did not require an allocation to determine whether the disqualified person's compensation is reasonable for purposes of chapter 42 could have the opposite effect. The insurance allocation rules are now set forth in §53.4941(d)–2(f)(5).

Some commentators requested a clearer statement of what is meant by the statement that indemnification or insurance premiums are to be treated as compensation to the benefiting foundation manager. The IRS and the Treasury Department agree that further clarification is desirable. Accordingly, §53.4941(d)–2(f)(7) has been added. It provides that treatment as compensation for the limited purpose of determining whether compensation is reasonable under chapter 42 is separate and distinct from treatment as income to the benefiting manager under the income tax provisions. Whether any amount of indemnification or insurance is included in the manager's gross income for individual income tax purposes is determined in accordance with section 132, without regard to the treatment of such amounts under chapter 42.

Finally, a provision has been added to the regulations specifying that a foundation may disregard de minimis benefits when calculating the total amount of compensation paid to an officer, director or foundation manager for purposes of determining whether that compensation is reasonable. In this context, a de minimis benefit is one excluded from gross income under section 132(a)(4). This provision makes explicit a Service position that has previously been reflected in the instructions to the Form 990–PF.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not

apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this Treasury decision is Terri Harris, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, personnel from other offices of the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 53 is amended as follows:

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Paragraph 1. The authority for part 53 continues to read as follows:

Authority 26 U.S.C. 7805.

Par. 2. Section 53.4941(d)–2 is amended as follows:

1. Paragraph (f)(1) is amended by removing the second and third sentences and revising the fourth sentence.

2. Paragraph (f)(3) is revised.

3. Paragraph (f)(4) is redesignated as paragraph (f)(9).

4. New paragraphs (f)(4) through (f)(8) are added.

The additions and revisions read as follows:

§53.4941(d)–2 Specific acts of self-dealing.

* * * * * *

(f) *Transfer or use of the income or assets of a private foundation*—(1) *In general.* * * * For purposes of the preceding sentence, the purchase or sale of stock or other securities by a private foundation shall be an act of self-dealing if such purchase or sale is made in an attempt to manipulate the price of the stock or other securities to the advantage of a disqualified person. * * *

* * * * * *

(3) *Non-compensatory indemnification of foundation managers against liability for defense in civil proceedings.* (i) Except as provided in §53.4941(d)–3(c), section 4941(d)(1) shall not apply to the indemnification by a private foundation of a foundation manager, with respect to the manager's defense in any civil judicial or civil administrative proceeding arising out of the manager's performance of services (or failure to perform services) on behalf of the foundation, against all expenses (other than taxes, including taxes imposed by chapter 42, penalties, or expenses of correction) including attorneys' fees, judgments and settlement expenditures if—

(A) Such expenses are reasonably incurred by the manager in connection with such proceeding; and

(B) The manager has not acted willfully and without reasonable cause with respect to the act or failure to act which led to such proceeding or to liability for tax under chapter 42.

(ii) Similarly, except as provided in §53.4941(d)–3(c), section 4941(d)(1) shall not apply to premiums for insurance to make or to reimburse a foundation for an indemnification payment allowed pursuant to this paragraph (f)(3). Neither shall an indemnification or payment of insurance allowed pursuant to this paragraph (f)(3) be treated as part of the compensation paid to such manager for purposes of determining whether the compensation is reasonable under chapter 42.

(4) *Compensatory indemnification of foundation managers against liability for defense in civil proceedings.* (i) The indemnification by a private foundation of a foundation manager for compensatory expenses shall be an act of self-dealing under this paragraph unless when such payment is added to other compensation paid to such manager the total compensation is reasonable under chapter 42. A compensatory expense for purposes of this paragraph (f) is—

(A) Any penalty, tax (including a tax imposed by chapter 42), or expense of correction that is owed by the foundation manager;

(B) Any expense not reasonably incurred by the manager in connection with a civil judicial or civil administrative proceeding arising out of the manager's performance of services on behalf of the foundation; or

(C) Any expense resulting from an act or failure to act with respect to which the manager has acted willfully and without reasonable cause.

(ii) Similarly, the payment by a private foundation of the premiums for an insurance policy providing liability insurance to a foundation manager for expenses described in this paragraph (f)(4) shall be an act of self-dealing under this paragraph (f) unless when such premiums are added to other compensation paid to such manager the total compensation is reasonable under chapter 42.

(5) *Insurance Allocation.* A private foundation shall not be engaged in an act of self-dealing if the foundation purchases a single insurance policy to provide its managers both the noncompensatory and the compensatory coverage discussed in this paragraph (f), provided that the total insurance premium is allocated and that each manager's portion of the premium attributable to the compensatory coverage is included in that manager's compensation for purposes of determining reasonable compensation under chapter 42.

(6) *Indemnification.* For purposes of this paragraph (f), the term *indemnification* shall include not only reimbursement by the foundation for expenses that the foundation manager has already incurred or anticipates incurring but also direct payment by the foundation of such expenses as the expenses arise.

(7) *Taxable Income.* The determination of whether any amount of indemnification or insurance premium discussed in this paragraph (f) is included in the manager's gross income for individual income tax purposes is made on the basis of the provisions of chapter 1 and without regard to the treatment of such amount for purposes of determining whether the manager's compensation is reasonable under chapter 42.

(8) *De minimis items.* Any property or service that is excluded from income under section 132(a)(4) may be disregarded for purposes of determining whether the recipient's compensation is reasonable under chapter 42.

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Margaret Milner Richardson.
Commissioner of Internal Revenue.

Approved December 12, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 19, 1995, 8:45 a.m., and published in the issue of the Federal Register for December 20, 1995, 60 F.R. 65566)

Section 6011.—General Requirement of Return, State or List

Printing of substitutes for Form W–2, Wage and Tax Statements, and Form W–3, Transmittals of Income and Tax Statements. See Rev. Proc. 96–23, page 27.

Section 6041.—Information at Source

26 CFR 1.6041–1: Return of information as to payments of $600 or more.

Printing of substitutes for Form W–2, Wage and Tax Statements, and Form W–3, Transmittal of Income and Tax Statements. See Rev. Proc. 96–23, page 27.

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26 CFR 1.6041–2: Return of information as to payments to employees.

Printing of substitutes for Form W–2, Wage and Tax Statement, and Form W–3, Transmittal of Income and Tax Statements. See Rev. Proc. 96–23, page 27.

Section 6051.—Receipts for Employees

26 CFR 31.6051–1: Statements for employees.

Printing of substitutes for Form W–2, Wage and Tax Statement, and Form W–3, Transmittal of Income and Tax Statements. See Rev. Proc. 96–23, page 27.

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26 CFR 31.6051–2: Information on Form W–3 and Internal Revenue Service copies of Form W–2.

Printing of substitutes for Form W–2, Wage and Tax Statement, and Form W–3, Transmittal of Income and Tax Statements. See Rev. Proc. 96–23, page 27.

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 31.6071(a)–1: Time for filing returns and other documents.

Printing of substitutes for Form W–2, Wage and Tax Statement, and Form W–3, Transmittal of Income and Tax Statements. See Rev. Proc. 96–23, page 27.

Section 6081.—Extension of Time for Filing Returns

26 CFR 31.6081(a)–1: Extension of time for filing returns.

Printing of substitutes for Form W–2, Wage and Tax Statement, and Form W–3, Transmittal of Income and Tax Statements. See Rev. Proc. 96–23, page 27.

Section 6091.—Place for Filing Returns or Other Documents

Printing of substitutes for Form W–2, Wage and Tax Statement, and Form W–3, Transmittal of Income and Tax Statements. See Rev. Proc. 96–23, page 27.

Notice of Proposed Rulemaking

Effect of the Family and Medical Leave Act on the Operation of Cafeteria Plans

EE–20–95

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to cafeteria plans that reflect changes made by the Family and Medical Leave Act of 1993. The proposed regulations provide the public with guidance needed to comply with the Act and affect employees who participate in cafeteria plans.

DATES: Written comments and requests for a public hearing must be received by March 20, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (EE–20–95), Room 5228, Internal Revenue Service, POB 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 (EE–20–95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Catherine Fuller, (202) 622-6080; concerning submissions and the hearing, Mike Slaughter, (202) 622-8452 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed additions to the Income Tax Regulations (26 CFR Part 1) under section 125 of the Internal Revenue Code of 1986 (Code). These additions are proposed to conform the regulations to the Family and Medical Leave Act of 1993 (FMLA), Public Law 103–3. FMLA imposes certain requirements on employers regarding coverage, including family coverage, under group health plans for employees taking FMLA leave, and regarding the restoration of benefits to employees who return from FMLA leave. This notice of proposed rulemaking addresses a number of the principle questions that have been raised about how these FMLA requirements affect the operation of cafeteria plans (including flexible spending arrangements) maintained under section 125 of the Code. The rules in this notice of proposed rulemaking supplement the proposed Income Tax Regulations under section 125 of the Code. Except as otherwise provided in this notice of proposed rulemaking, all of the existing rules governing cafeteria plans, including the nondiscrimination rules, continue to apply.

The requirements pertaining to FMLA leave, including the employer's obligation to maintain coverage under a group health plan during FMLA leave and to restore benefits upon return from FMLA leave, are established by FMLA, not the Code. The U.S. Department of Labor, in 29 CFR Part 825, has published rules interpreting the requirements of FMLA, and the Department of Labor has jurisdiction relating to those rights or obligations. This notice of proposed rulemaking does not interpret FMLA; it provides

guidance on the cafeteria plan rules that apply to an employee in circumstances to which FMLA and the Labor Regulations thereunder also apply. The Department of Labor has advised the Department of the Treasury, including the Internal Revenue Service (IRS), that the provisions of this notice of proposed rulemaking do not conflict with, and are not inconsistent with, the provisions of FMLA or the Labor Regulations thereunder.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the 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 these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the Federal Register.

Drafting Information

The principal author of these regulations is Catherine Fuller, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Department of the Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.125–3 is added to read as follows:

§1.125–3 Effect of the Family and Medical Leave Act (FMLA) on the operation of cafeteria plans.

Q-1: *May an employee taking FMLA leave revoke an existing election of group health plan coverage under a cafeteria plan*?

A-1: Yes. An employee taking FMLA leave may revoke an existing election of group health plan coverage (including a health flexible spending arrangement (FSA)) under a cafeteria plan for the remaining portion of the coverage period. See 29 CFR 825.209-(e). FMLA also requires that an employee be permitted to choose to be reinstated in the group health plan coverage (including a health FSA) provided under a cafeteria plan upon returning from FMLA leave if the employee's group health plan coverage terminated while on FMLA leave (either by revocation or nonpayment of premiums). Such an employee is entitled, under FMLA, to be reinstated on the same terms as prior to taking FMLA leave (including family or dependent coverage). See 29 CFR 825.209(e) and 825.215(d). However, the employee has no greater right to benefits for the remainder of the plan year than an employee who has been continuously working during the plan year. In addition to the rights granted under FMLA, such an employee has the right to revoke or change elections (*e.g.*, because of changes in family status or significant cost or coverage changes imposed by a third-party provider) under the same terms and conditions as are available to employees participating in the cafeteria plan who are not on FMLA leave.

Q-2: *Who is responsible for making premium payments under a cafeteria plan when an employee on FMLA leave continues group health plan coverage*?

A-2: An employee is entitled to continue group health plan coverage (including a health FSA) during FMLA leave whether or not provided under a health FSA or other component of a cafeteria plan. See 29 CFR 825.209(b). An employee making premium payments under a cafeteria plan who chooses to continue group health plan coverage (including a health FSA) while on FMLA leave is responsible for the share of group health premiums that the employee was paying while working, such as amounts paid pursuant to a salary reduction agreement. The employer must continue to contribute the share of the cost of the employee's coverage that the employer was paying before the employee commenced FMLA leave. See 29 CFR 825.100(b) and 825.210(a).

Q-3: *What payment options are required or permitted to be offered under a cafeteria plan to an employee who continues group health plan coverage (including a health FSA) while on unpaid FMLA leave, and what is the tax treatment of these payments?*

A-3: (a) *In general* A cafeteria plan may, on a nondiscriminatory basis, offer one or more of the following payment options (subject to the limitations described in paragraph (b) of this Q&A-3) to an employee who continues group health plan coverage (including a health FSA) while on unpaid FMLA leave. These options are referred to in this section as pre-pay, pay-as-you-go and catch-up.

(1) *Pre-pay.* (i) Under the pre-pay option, a cafeteria plan may permit an employee to pay, prior to commencement of the FMLA leave period, the amounts due for the FMLA leave period. However, the Labor Regulations under FMLA provide that under no circumstances may the employer mandate that an employee pre-pay the amounts due for the leave period. See 29 CFR 825.210(c)(3) and (4).

(ii) Contributions under the pre-pay option may be made on a pre-tax salary reduction basis from any taxable compensation (including the cashing out of unused sick days or vacation days). These contributions will not be included in the employee's gross income, provided that all cafeteria plan requirements are satisfied. For example, see

Q&A-5 of this section regarding restrictions on pre-tax salary reduction contributions when an employee's FMLA leave spans two cafeteria plan years.

(iii) Contributions under the pre-pay option may also be made on an after-tax basis. See §1.125–1, Q&A-5.[1]

(2) *Pay-as-you-go.* (i) Under the pay-as-you-go option, employees may pay their share of the premium payments on the same schedule as payments would be made if the employee were not on leave or under any other payment schedule permitted by the Labor Regulations at 29 CFR 825.210-(c) (*i.e.,* on the same schedule as payments are made under the Consolidated Omnibus Reconciliation Act of 1985, Public Law 99–272; under the employer's existing rules for payment by employees on leave without pay; or under any other system voluntarily agreed to between the employer and the employee that is not inconsistent with this section or with 29 CFR 825.210(c)).

(ii) Contributions under the pay-as-you-go option are generally made by the employee on an after-tax basis. However, contributions may be made on a pre-tax basis to the extent that the contributions are made from taxable compensation (*e.g.,* cashing out unused sick or vacation days) that is due the employee during the leave period, and provided that all cafeteria plan requirements are satisfied.

(iii) An employer is not required to continue the health coverage of an employee who fails to make required premium payments while on FMLA leave. See 29 CFR 825.212. However, if the employer chooses to continue the health coverage of an employee who fails to make required premium payments while on FMLA leave, the employer is entitled to recoup those payments as set forth in paragraph (a)(3)(i) of this Q&A-3. See also Q&A-6 of this section regarding coverage under a health FSA when an employee fails to make the required premium payments while on FMLA leave.

(3) *Catch-up.* (i) An employer that continues providing group health coverage to an employee who does not pay premiums on FMLA leave is, to the extent provided under the Labor Regulations, permitted to utilize the catch-up option to recoup the employee's share of premium payments. See, *e.g.,* 29 CFR 825.212(b).

(ii) Where an employee is electing to use the catch-up option, the employer and the employee must agree in advance of the coverage period that: the employee elects to continue health coverage while on unpaid FMLA leave; the employer will assume responsibility for advancing payment of the premiums on the employee's behalf during the FMLA leave; and these advance amounts must be paid by the employee when the employee returns from FMLA leave.

(iii) Contributions under the catch-up option may be made on a pre-tax salary reduction basis when the employee returns from FMLA leave from any available taxable compensation (including the cashing out of unused sick days and vacation days). These contributions will not be included in the employee's gross income, provided that all cafeteria plan requirements are satisfied.

(iv) Contributions under the catch-up option may also be made on an after-tax basis. See §1.125–1, Q&A-5.[2]

(b) *Exceptions* Cafeteria plans may offer (pursuant to 29 CFR 825.210(c)) one or more of the payment options described in paragraph (a) of this Q&A-3, with the following exceptions:

(1) The pre-pay option cannot be the sole option offered to employees on FMLA leave. However, the cafeteria plan may include pre-payment as an option for employees on FMLA leave, even if such option is not offered to employees on non-FMLA leave-without-pay.

(2) The catch-up option can be the sole option offered to employees on FMLA leave if and only if the catch-up option is the sole option offered to employees on non-FMLA leave-without-pay.

(3) A cafeteria plan cannot offer employees on FMLA leave a choice of either the pre-pay option or the catch-up option without also offering the pay-as-you-go option, if the pay-as-you-go option is offered to employees on non-FMLA leave-without-pay.

(c) *Voluntary waiver of employee payments* In addition to the foregoing payment options, an employer may voluntarily waive, on a nondiscriminatory basis, the requirement that employees who elect to continue health coverage while on FMLA leave pay the amounts the employees would otherwise be required to pay for the leave period.

Q-4: *Do the special FMLA requirements concerning an employee who continues group health plan coverage under a cafeteria plan apply if the employee is on paid FMLA leave*?

A-4: No. The Labor Regulations provide that, if an employee's FMLA leave is substituted paid leave as described at 29 CFR 825.207 and the employee continues group health plan coverage while on FMLA leave, the employee's share of the premiums must be paid by the method normally used during any paid leave (*i.e.,* salary reduction). See 29 CFR 825.210(b).

Q-5: *What restrictions apply to contributions when an employee's FMLA leave spans two cafeteria plan years*?

A-5: (a) Contributions to a cafeteria plan during FMLA leave will not be included in an employee's gross income, provided that the plan complies with all cafeteria plan requirements. Among other requirements, a plan may not operate in a manner that enables employees on FMLA leave to defer compensation from one cafeteria plan year to a subsequent cafeteria plan year. See §1.125-2, Q&A-5.[3]

(b) The following example illustrates this Q&A-5:

Example. Employee A elects health coverage under a calendar year cafeteria plan maintained by Employer X. A's premium for health coverage is $100 per month throughout the 12-month period of coverage. A takes FMLA leave for 12 weeks beginning on October 31 after making 10 months worth of premiums totalling $1000 (10 months × $100 = $1000). A maintains health coverage while on FMLA leave. A utilizes the *pre-pay* option by cashing-out A's unused sick days in order to make the required premium payments due while A is on FMLA leave. Because A cannot defer compensation from one plan year to a subsequent plan year, A may pre-pay the premiums due in November and December (*i.e.,* $100 per month) on a pre-tax basis, but A cannot pre-pay the premium payment due in January on a pre-tax basis. If A participates in the cafeteria plan in the subsequent plan year, A

[1]Published as a proposed rule at 49 FR 19321 [EE–16–79, 1984–1 C.B. 563] (May 7, 1984).

[2]Published as a proposed rule at 49 FR 19321 (May 7, 1984).

[3]Published as a proposed rule at 54 FR 9460 [EE–130–86, 1989–1 C.B. 944] (March 7, 1989).

must use another option (*e.g.,* pay-as-you-go or catch-up) to make the premium payment due in January.

Q-6: *Are there special rules concerning employees taking FMLA leave who participate in health FSAs offered under a cafeteria plan*?

A-6: (a) *In general* (1) A health plan that is a flexible spending arrangement (FSA) offered under a cafeteria plan must conform to the generally applicable rules in this section concerning employees who take FMLA leave. Thus, FMLA requires that an employee taking FMLA leave be permitted to—

(i) continue coverage under a health FSA while on FMLA leave; or

(ii) revoke an existing health FSA election under the cafeteria plan for the remainder of the coverage period. See 29 CFR 825.209(e).

(2) FMLA also requires the plan to permit the employee to be reinstated in the health FSA upon return from FMLA leave on the same terms as prior to taking FMLA leave. See 29 CFR 825.215(d) and paragraph (b)(2) of this Q&A-6. However, reinstatement is at the employee's election and under no circumstances may an employer require an employee whose coverage has terminated while on FMLA leave to reinstate coverage under a health FSA upon return from FMLA leave. See 29 CFR 825.214(a).

(b) *Uniform Coverage Rule* (1) Q&A-7(b)(2) of §1.125–2[4] (the uniform coverage rule) applies during the FMLA leave period as long as the employee continues health coverage. Therefore, regardless of the payment option selected under Q&A-3 of this section, for so long as the employee continues coverage (or for so long as the employer continues the coverage of an employee who fails to make the required contributions as described in Q&A-3(a)(2)(iii) of this section), the full amount of the elected coverage, less any prior reimbursements, must be available to the employee at all times, including the FMLA leave period.

(2)(i) If an employee's coverage under the health FSA terminates while the employee is on FMLA leave, the employee is not entitled to receive reimbursements for claims incurred during the period when the coverage is terminated. If that employee subsequently elects to be reinstated in the health FSA upon return from FMLA leave for the remainder of the plan year, the employee may not retroactively elect health FSA coverage for claims incurred during the period when the coverage was terminated. Further, the employee is not entitled to greater FSA benefits relative to premiums paid than an employee who has been continuously working during the plan year. See 29 CFR 825.216. Therefore, if an employee elects to be reinstated in a health FSA upon return from FMLA leave, the employee's coverage for the remainder of the plan year is equal to the employee's election for the 12-month period of coverage (or such shorter period as provided under §1.125–2[5]), prorated for the period during the FMLA leave for which no premiums were paid, and reduced by prior reimbursements.

(ii) An employee on FMLA leave has the right to revoke or change elections (*e.g.,* because of changes in family status) under the same terms and conditions that apply to employees participating in the cafeteria plan who are not on FMLA leave. Thus, notwithstanding the rules described in paragraph (b)(2)(i) of this Q&A-6, an employee who returns from FMLA leave may make a new health FSA election for the remainder of the plan year if return from leave without pay constitutes a change of family status under the employer's cafeteria plan.

(3) The following examples illustrate the rules in this Q&A-6:

Example 1: (a) Employee A elects $1200 worth of coverage under a calendar year health FSA provided under a cafeteria plan, with an annual premium of $1200. A is permitted to pay the $1200 through pre-tax salary reduction amounts of $100 per month throughout the 12-month period of coverage. A incurs no medical expenses prior to April 1. On April 1, A takes FMLA leave after making three months worth of contributions totalling $300 (3 months × $100 = $300). The plan does not permit a revocation of election on account of a change in family status. However, pursuant to A's rights under FMLA, A elects to terminate coverage upon going on FMLA leave. Consequently, A makes no premium payments for the months of April, May, and June, and A is not entitled to submit claims or receive reimbursements for expenses incurred during this period. A returns from FMLA leave and elects to be reinstated in the health FSA on July 1.

(b) Under FMLA, A has no greater right to benefits upon reinstatement than if A had been continuously working during the plan year. Therefore, A is reinstated to A's annual election (*i.e.,* $1200) prorated for the period during the FMLA leave for which no premiums were paid (*i.e.,* reduced for 3 months or 1/4 of the plan year) less prior reimbursements (*i.e.,* $0). Consequently, A's coverage for the remainder of the plan year equals $900. A must also begin making premium payments of $100 per month for the remainder of the plan year.

Example 2: Assume the same facts as *Example 1* except that A incurs medical expenses totaling $200 in February and obtains reimbursement of these expenses. The results are the same as in *Example 1*, except that A's coverage for the remainder of the plan year equals $700.

Example 3: Assume the same facts as *Example 1* except that prior to taking FMLA leave, A elects to continue health FSA coverage during the FMLA leave. The plan permits A (and A elects) to use the catch-up payment option described in Q&A-3 of this section, and as further permitted under the plan, A chooses to repay the $300 in missed payments on a ratable basis over the remaining six-month period of coverage (*i.e.,* $50 per month). Thus, A's monthly premium payments for the remainder of the plan year will be $150 ($100 + $50).

Q-7: *Are employees entitled to non-health benefits while taking FMLA leave*?

A-7: FMLA does not require an employer to maintain an employee's non-health benefits (*e.g.,* life insurance) during FMLA leave. An employee's entitlement to benefits other than group health benefits under a cafeteria plan during a period of FMLA leave is to be determined by the employer's established policy for providing such benefits when the employee is on non-FMLA leave (paid or unpaid). See 29 CFR 825.209(h). Therefore, an employee who takes FMLA leave is entitled to revoke an election of non-health benefits under a cafeteria plan to the same extent employees taking non-FMLA leave are permitted to revoke elections of non-health benefits under a cafeteria plan. For example, election changes are permitted due to changes of family status or upon enrollment for a new plan year. See §1.125–2, Q&A-6(c)[6] and §1.125–1, Q&A-8[7]. However, the FMLA regulations provide that, in certain cases, an employer may continue an employee's non-health benefits under the employer's cafeteria plan while the employee is on FMLA leave to ensure that the employer can meet its responsibility to provide equivalent benefits to

[4]Published as a proposed rule at 54 FR 9460 (March 7, 1989).

[5]Published as a proposed rule at 54 FR 9460 (March 7, 1989).

[6]Published as a proposed rule at 54 FR 9460 (March 7, 1989).

[7]Published as a proposed rule at 49 FR 19321 (May 7, 1984).

the employee upon return from unpaid FMLA. If the employer continues an employee's non-health benefits during FMLA leave, the employer is entitled to recoup the costs incurred for paying the employee's share of the premiums during the FMLA leave period. See 29 CFR 825.213(b). In addition, a cafeteria plan must, as required by FMLA, permit an employee whose coverage terminated while on FMLA leave (either by revocation or nonpayment of premiums) to be reinstated in the cafeteria plan on return from FMLA leave. See 29 CFR 825.214(a) and 825.215(d).

Q-8: *How may taxpayers rely on these proposed regulations*?

A-8: (a) The guidance provided by the questions and answers in this section may be relied upon to comply with provisions of section 125 and will be applied by the Internal Revenue Service in resolving issues arising under cafeteria plans and related Internal Revenue Code sections. If final regulations are more restrictive than the guidance in this section, the regulations will not be applied retroactively. No inference, however, should be drawn regarding issues not expressly raised that may be suggested by a particular question or answer or by the inclusion or exclusion of certain questions.

(b) The Department of Labor has advised the Department of the Treasury, including the Internal Revenue Service, that the provisions of this section are not inconsistent with the provisions of FMLA and the Labor Regulations thereunder.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 20, 1995, 8:45 a.m., and published in the issue of the Federal Register for December 21, 1995, 60 F.R. 66229)

Notice of Proposed Rulemaking

Allocation of Accrued Benefits Between Employer and Employee Contributions

EE–35–95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance on calculation of an employee's accrued benefit derived from the employee's contributions to a qualified defined benefit pension plan. These regulations are issued to reflect changes to the applicable law made by the Omnibus Budget Reconciliation Act of 1987 (OBRA '87) and the Omnibus Budget Reconciliation Act of 1989 (OBRA '89). OBRA '87 and OBRA '89 amended the law to change the accumulation of employee contributions and the conversion of those accumulated contributions to employee-derived accrued benefits.

DATES: Written comments and requests for a public hearing must be received by March 21, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (EE–35–95), Room 5228, Internal Revenue Service, POB 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 (EE–35–95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Janet A. Laufer, (202) 622-4606, concerning submissions, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to regulations containing rules for computing an employee's accrued benefit derived from the employee's contributions to a qualified defined benefit pension plan. The proposed amendments reflect changes made to section 411(c)(2) by the Omnibus Budget Reconciliation Act of 1987, Public Law 100–203 (OBRA '87), and the Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (OBRA '89). OBRA '87 and OBRA '89 changed the interest rates used to accumulate an employee's contributions to normal retirement age. OBRA '89 also changed the manner in which the accumulated contributions are converted to an annual benefit payable at normal retirement age, and removed a limitation on the employee-derived accrued benefit contained in prior law.

Section 411(c)(1) provides that an employee's accrued benefit derived from employer contributions as of any applicable date is the excess, if any, of the accrued benefit for the employee as of that date over the accrued benefit derived from contributions made by the employee as of that date. Section 411(c)(2)(B) provides that in the case of a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is the amount equal to the employee's contributions accumulated to normal retirement age using the interest rate(s) specified in section 411(c)(2)(C), expressed as an actuarially equivalent annual benefit commencing at normal retirement age using an interest rate which would be used by the plan under section 417(e)(3), as of the determination date. If the employee-derived accrued benefit is determined with respect to a benefit other than an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, section 411(c)(3) requires that the employee-derived accrued benefit be the actuarial equivalent of the benefit determined under section 411(c)(2).

Under section 411(c)(2)(C)(iii)(I), effective for plan years beginning after December 31, 1987, the interest rate used to accumulate an employee's contributions until the determination date is 120 percent of the Federal mid-term rate under section 1274 of the Internal Revenue Code (Code). For the period between the determination date and normal retirement age, section 411(c)(2)(C)(iii)(II) provides that the interest rate used to accumulate an employee's contributions is the interest rate which would be used under the plan under section 417(e)(3) as of the determination date. As noted above, section 411(c)(2)(B) provides that the interest rate which would be used under the plan under section 417(e)(3) as of the determination date also applies for purposes of converting the accumulated contributions to an annual benefit commencing at normal retirement age. The Retirement Protection Act of 1994, Public Law 103–465 (RPA '94) amended section 417(e) to change the applicable interest rate

under section 417(e)(3) and to specify the applicable mortality table under that section. Examples contained in §1.411(c)–1(c)(6) of these proposed regulations reflect a plan that has been amended to comply with the interest rate and mortality table specifications enacted in RPA '94.

Explanation of Provisions

1. *Conversion calculation*

Prior to OBRA '89, section 411(c)-(2)(B) specified that the conversion factor to be used for purposes of computing the employee-derived accrued benefit was 10 percent for a straight life annuity commencing at normal retirement age of 65 (*i.e.*, multiply the accumulated contributions by .10), and that for other normal retirement ages the conversion factor was to be determined in accordance with regulations prescribed by the Secretary. Section 1.411(c)–1(c)(2) of the existing regulations provides that for normal retirement ages other than age 65, the conversion factor shall be the factor as determined by the Commissioner.

Rev. Rul. 76–47 (1976–1 C.B. 109) sets forth in tabular form the conversion factors to be used for determining the accrued benefit derived from employee contributions when the normal retirement age under the plan is other than age 65 or when the normal form of benefit is other than a single life annuity (without ancillary benefits). Rev. Rul 76–47 further provides that where no standard factor is available, a conversion factor must be determined using an interest rate of 5 percent and the UP–1984 mortality table (without age setback).

OBRA '89 deleted the ten percent conversion factor in section 411(c)-(2)(B) and replaced it with the requirement that the accumulated contributions at normal retirement age be expressed as an annual benefit commencing at normal retirement age using an interest rate which would be used under the plan under section 417(e)(3) (as of the determination date). This change was effective retroactively to the effective date of the OBRA '87 provision relating to section 411(c)(2)(C) (the first day of the first plan year beginning after December 31, 1987).

To reflect the OBRA '89 amendments, these proposed regulations define *appropriate conversion factor* with respect to an accrued benefit expressed in the form of an annual benefit that is nondecreasing for the life of the participant as the present value of an annuity in the form of that annual benefit commencing at normal retirement age at a rate of $1 per year. This amount is to be computed using the interest rate and mortality table which would be used under the plan under section 417(e)(3) and §1.417(e)–1T. To reflect the post-OBRA '89 conversion factor definition and to conform to common actuarial practice, these proposed regulations would change the *multiplied by* language in §1.411(c)–1(c)(1) to *divided by*.

2. *Accumulated contributions*

As added by the Employee Retirement Income Security Act of 1974 (ERISA), section 411(c)(2)(C) provided that employee contributions were to be accumulated using a standard interest rate of 5 percent for years beginning on or after the effective date of that section. OBRA '87 changed the interest rate under section 411(c)(2)(C) to 120 percent of the applicable Federal mid-term rate under section 1274 for plan years after 1987. OBRA '89 again amended section 411(c)(2)(C) to provide that 120 percent of the applicable Federal mid-term rate under section 1274 is to be used for accumulating contributions only up to the *determination date*. For the period from the determination date to normal retirement age, the interest rate which would be used under the plan under section 417(e)(3) (as of the determination date) must be used for accumulating contributions for the period from the determination date to normal retirement age. Accordingly, these proposed regulations would amend paragraph (3) of §1.411(c)–1(c) to reflect those rates. As stated above, RPA '94 amended section 417(e)(3) to change the applicable interest rate. See §1.417(e)–1T.

3. *Determination date*

Section 1.411(c)–1(c)(5)(i) defines the term determination date for purposes of section 411(c)(2)(C)(iii), in a case in which a participant will receive his or her entire accrued benefit derived from employee contributions in any one of the following forms (described in paragraph (c)(5)(ii)): an annuity that is substantially nonincreasing, substantially nonincreasing installment payments for a fixed number of years, or a single sum distribution. In such a case, the term determination date means the date on which distribution of such benefit commences. For this purpose, an annuity that is nonincreasing except for automatic increases to reflect increases in the consumer price index is considered to be an annuity that is substantially nonincreasing.

Thus, for example, for purposes of section 411(c)(2)(C)(iii), in the case of a distribution of the employee's entire accrued benefit (or the employee's entire employee-derived accrued benefit) in the form of a nonincreasing single life annuity payable commencing either at normal retirement age or at early retirement age, the determination date is the date the annuity commences. Similarly, in the case of a single sum distribution of accumulated employee contributions (*i.e.*, employee contributions plus interest computed at or above the section 411(c) required rates) upon termination of employment with a deferred annuity benefit derived solely from employer contributions, the determination date is the date of distribution of the single sum of accumulated employee contributions.

Alternatively, the plan may provide that the determination date is the annuity starting date, as defined in §1.401(a)–20, Q&A-10.

Under §1.411(c)–1(c)(5)(iii) of these regulations, where a participant will receive a distribution that is not described in paragraph (c)(5)(i), the determination date will be as provided by the Commissioner.

4. *Elimination of limitation on employee-derived accrued benefit*

Prior to OBRA '89, section 411(c)(2)(E) of the Code limited the accrued benefit derived from employee contributions to the greater of (1) the employee's accrued benefit under the plan, or (2) the sum of the employee's mandatory contributions, without interest. Section 7881(m)(1)(C) of OBRA '89 deleted that provision. Section 7881(m)(1)(D) of OBRA '89 added section 411(a)(7)(D) to the Code, which provides that the accrued benefit of an employee shall not be less than the amount determined under section 411(c)(2)(B) with respect to the

employee's accumulated contributions. Accordingly, these proposed regulations delete the rule included in §1.411(c)–1(d) of the existing regulations, which reflects the pre-OBRA '89 rule.

5. *Delegation of authority*

Section 1.411(c)–1(d) of these proposed regulations provides that the Commissioner may prescribe additional guidance on calculating the accrued benefit derived from employer or employee contributions under a defined benefit plan.

Effective Date

These amendments are proposed to be effective for plan years beginning on or after January 1, 1997. For example, assume that under a plan the employee's date of termination of employment is treated as the determination date, and distribution of the employee's entire employee-derived accrued benefit (as determined under the terms of the plan then in effect) occurs or commences prior to the first day of the plan year beginning in 1997. In that case, with respect to interest credits under section 411(c)(2)(C)(iii) for plan years beginning after 1987, the Service will not treat the plan as having failed to satisfy the requirements of section 411(c), nor will it require that additional amounts be credited in the calculation of the employee-derived accrued benefit in order to satisfy the requirements of section 411(c) after final regulations become effective, merely because the date the employee's employment terminated was treated as the determination date, provided that interest is credited in accordance with section 411(c)(2)(C)(iii)(I) for the period before the date the employee terminated employment and in accordance with section 411(c)(2)(C)(iii)(II) thereafter.

Once amendments to the regulations under §1.411(c)–1 are adopted in final form, the Service will obsolete or modify Rev. Rul. 76–47, Rev. Rul. 78–202 (1978–2 C.B. 124) and Rev. Rul. 89–60 (1989–1 C.B. 113) as necessary or appropriate.

Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the Federal Register.

Drafting Information

The principal author of these regulations is Janet A. Laufer, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 continues to read in part as follows:

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

Par. 2. Section 1.411(c)–1 is amended by:

1. Revising paragraphs (c)(1), (c)(2), (c)(3), (c)(5) and (c)(6).

2. Revising paragraph (d).

3. Adding paragraph (g).

The additions and revisions read as follows:

§1.411(c)–1 Allocation of accrued benefits between employer and employee contributions.

* * * * * *

(c) *Accrued benefit derived from mandatory employee contributions to a defined benefit plan*—(1) *General Rule*. In the case of a defined benefit plan (as defined in section 414(j)), the accrued benefit derived from contributions made by an employee under the plan as of any applicable date in the form of an annual benefit commencing at normal retirement age and nondecreasing for the life of the participant is equal to the amount of the employee's accumulated contributions (determined under paragraph (c)(3) of this section) divided by the appropriate conversion factor with respect to that form of benefit (determined under paragraph (c)(2) of this section). Paragraph (e) of this section provides rules for actuarial adjustments where the benefit is to be determined in a form other than the form described in this paragraph (c)(1).

(2) *Appropriate conversion factor*. For purposes of this paragraph, with respect to a form of annual benefit commencing at normal retirement age described in paragraph (c)(1), the term *appropriate conversion factor* means the present value of an annuity in the form of that annual benefit commencing at normal retirement age at a rate of $1 per year, computed using an interest rate and mortality table which would be used under the plan under section 417(e)(3) and §1.417(e)–1T (as of the determination date).

(3) *Accumulated contributions*. For purposes of section 411(c) and this section, the term *accumulated contributions* means the total of—

(i) All mandatory contributions made by the employee (determined under paragraph (c)(4) of this section);

(ii) Interest (if any) on such contributions, computed at the rate provided by the plan to the end of the last plan year to which section 411(a)(2) does not apply (by reason of the applicable effective dates);

(iii) Interest on the sum of the amounts determined under paragraphs (c)(3)(i) and (ii) of this section compounded annually at the rate of 5 percent per annum from the beginning of the first plan year to which section 411(a)(2) applies (by reason of the applicable effective date) to the beginning of the first plan year beginning after December 31, 1987;

(iv) Interest on the sum of the amounts determined under paragraphs (c)(3)(i) through (iii) of this section compounded annually at 120 percent of the Federal mid-term rate(s) (as in effect under section 1274(d) of the Internal Revenue Code for the first month of a plan year) for the period beginning with the first plan year beginning after December 31, 1987 and ending on the determination date; and

(v) Interest on the sum of the amounts determined under paragraphs (c)(3)(i) through (iv) of this section compounded annually, using an interest rate which would be used under the plan under section 417(e)(3) and §1.417(e)–1T (as of the determination date), from the determination date to the date on which the employee would attain normal retirement age.

* * * * * *

(5) *Determination date*—(i) For purposes of section 411(c) and this section, in a case in which a participant will receive his or her entire accrued benefit derived from employee contributions in any one of the forms described in paragraph (c)(5)(ii), the term *determination date* means the date on which distribution of such benefit commences. Alternatively, in such a case, the plan may provide that the determination date is the annuity starting date with respect to that benefit, as defined in §1.401(a)–20, Q&A-10.

(ii) Paragraph (c)(5)(i) applies to the following forms: an annuity that is substantially nonincreasing (*e.g.*, an annuity that is nonincreasing except for automatic increases to reflect increases in the consumer price index), substantially nonincreasing installment payments for a fixed number of years, or a single sum distribution.

(iii) In a case in which a participant will receive a distribution that is not described in paragraph (c)(5)(i), the determination date will be as provided by the Commissioner.

(6) *Examples*.

(i) *Facts*. (A) In the following examples, Employer X maintains a qualified defined benefit plan that required mandatory employee contributions for 1987 and prior years, but not for years after 1987. The plan year is the calendar year. The plan provides for a normal retirement age of 65 and for 100 percent vesting in the employer-derived portion of a participant's accrued benefit after 5 years of service.

(B) The terms of the plan provide that the normal form of benefit is a level monthly amount commencing at normal retirement age and payable for the life of the participant. A plan participant who elects not to receive benefits in the form of the qualified joint and survivor annuity provided by the plan may elect to receive a single-sum distribution of the present value of his or her accrued benefit upon termination of employment.

(C) As of January 1, 1995, the plan was amended to provide that, for purposes of computing actuarially equivalent benefits, the single sum is calculated using the unisex version of the 1983 GAM mortality table (as provided in Revenue Ruling 95–6 (1995–1 C.B. 80)), and interest at the rate equal to the annual rate of interest on 30-year Treasury securities for the first calendar month preceding the first day of the plan year during which the annuity starting date occurs.

(D) Under the plan, employee contributions are accumulated at 3 percent interest for plan years beginning before 1976, 5 percent interest for plan years beginning after 1975 and before 1988, and interest at 120 percent of the Federal mid-term rate (as in effect under section 1274(d) for the first month of the plan year) for plan years beginning after 1987 until the determination date. Under the plan, the determination date is defined as the annuity starting date. For the period from the determination date until the date on which the employee attains normal retirement age, interest is credited at the interest rate which would be used under the plan under section 417(e)(3) as of the determination date.

(E) A, an unmarried participant, terminates employment with X on January 1, 1997 at age 56 with 15 years of service. As of December 31, 1987, A's total accumulated mandatory employee contributions to the plan, including interest compounded annually at 5 percent for plan years beginning after 1975 and before 1988, equaled $3,021. A receives his or her accrued benefit in the form of an annual single life annuity commencing at normal retirement age. A's annuity starting date is January 1, 2006, and therefore the determination date is January 1, 2006.

(ii) *Annuity at Normal Retirement Age—Determination of Employee-Derived and Total Plan Vested Accrued Benefit*.

Example 1.

For purposes of this example, it is assumed that A's total accrued benefit under the plan in the normal form of benefit commencing at normal retirement age is $2,949 per year. A's benefit, as of January 1, 2006, would be determined as follows:

(1) Determine A's total accrued benefit in the form of an annual single life annuity commencing at normal retirement age under the plan's formula ($2,949 per year payable at age 65).

(2) Determine A's accumulated contributions with interest to January 1, 1997. As of December 31, 1987, A's accumulated contributions with interest under the plan provisions were $3,021. A's employee contributions are accumulated from December 31, 1987 to January 1, 1997 using 120 percent of the Federal mid-term rate under section 1274(d). This rate is 10.61 percent for 1988, 11.11 percent for 1989, 9.57 percent for 1990, 9.78 percent for 1991, 8.10 percent for 1992, 7.63 percent for 1993, 6.40 percent for 1994, and 9.54 percent for 1995. It is assumed for purposes of this example that 120 percent of the Federal mid-term rate is 7.00 percent for each year between 1996 and 2006, and that the 30-year Treasury rate for December 2005 is 8.00 percent. Thus, A's contributions accumulated to January 1, 1997, equal $6,480.

(3) Determine A's accumulated contributions with interest to normal retirement age (January 1, 2006) using, for the 1996 plan year and for years until normal retirement age, 120 percent of the Federal mid-term rate under section 1274(d), which is assumed to be 7.00 percent ($11,913).

(4) Determine the accrued annual annuity benefit derived from A's contributions by dividing A's accumulated contributions determined in paragraph (3) of this *Example 1* by the plan's appropriate conversion factor. The plan's appropriate conversion factor at age 65 is 9.196, and the accrued benefit derived from A's contributions would be $11,913 / 9.196 = $1,295.

(5) Determine the accrued benefit derived from employer contributions as the excess, if any, of the employee's accrued benefit under the plan over the accrued benefit derived from employee contributions ($2,949 – $1,295 = $1,654 per year).

(6) Determine the vested percentage of the accrued benefit derived from employer contributions under the plan's vesting schedule (100 percent).

(7) Determine the vested accrued benefit derived from employer contributions by multiplying the accrued benefit derived from employer contributions by the vested percentage ($1,654 x 100 percent = $1,654 per year).

(8) Determine A's vested accrued benefit in the form of an annual single life annuity commencing at normal retirement age by adding the accrued benefit derived from employee contributions and the vested accrued benefit derived from employer contributions, the sum of paragraphs (4) and (7) of this *Example 1* ($1,295 + $1,654 = $2,949 per year).

Example 2.

This example assumes the same facts as *Example 1* except that A's total accrued benefit under the plan in the normal form of benefit commencing at normal retirement age is $1,000 per year. A's benefit, as of January 1, 2006, would be determined as follows:

(1) Determine A's total accrued benefit in the form of an annual single life annuity commencing at normal retirement age under the plan's formula ($1,000 per year payable at age 65).

(2) Determine A's accumulated contributions with interest to January 1, 1997 ($6,480 from paragraph 2 of *Example 1*).

(3) Determine A's accumulated contributions with interest to normal retirement age (January 1, 2006) ($11,913 from paragraph 3 of *Example 1*).

(4) Determine the accrued annual annuity benefit derived from A's contributions by dividing A's accumulated contributions determined in paragraph (3) of this *Example 2* by the plan's appropriate conversion factor ($1,295 from paragraph 4 of *Example 1*).

(5) Determine the accrued benefit derived from employer contributions as the excess, if

any, of the employee's accrued benefit under the plan over the accrued benefit derived from employee contributions. Because the accrued benefit derived from employee contributions ($1,295) is greater than the employee's accrued benefit under the plan ($1,000), the accrued benefit derived from employer contributions is zero, and A's vested accrued benefit in the form of an annual single life annuity commencing at normal retirement age is $1,295 per year.

(d) *Delegation to Commissioner.* The Commissioner may prescribe additional guidance on calculating the accrued benefit derived from employee contributions under a defined benefit plan through publication in the Internal Revenue Bulletin of revenue rulings, notices, or other documents (see §601.601(d)(2) of this chapter).

(e) * * *

(f) * * *

(g) *Effective date.* Paragraphs (c)(1), (c)(2), (c)(3), (c)(5), (c)(6) and (d) of this section are effective for plan years beginning on or after January 1, 1997.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 21, 1995, 8:45 a.m., and published in the issue of the Federal Register for December 22, 1995, 60 F.R. 66532)

Notice of Proposed Rulemaking

Requirements for Tax Exempt Section 501(c)(5) Organizations

EE–53–95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: This document contains proposed regulations clarifying certain requirements of section 501(c)(5). The requirements are being clarified to provide needed guidance to organizations as to the requirements an organization must meet in order to be exempt from tax as an organization described in section 501(c)(5).

DATES: Written comments and requests for a public hearing must be received by March 20, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:T:R (EE–53–95), Room 5228, Internal Revenue Service, POB 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:T:R (EE–53–95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Robin Ehrenberg, (202) 622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This notice of proposed rulemaking clarifies the scope of the exemption provided in section 501(c)(5) of the Internal Revenue Code for labor, agricultural and horticultural organizations.

An income tax exemption for labor organizations was first provided in the Corporation Excise Tax Act of 1909, Public Law No. 61–5, 36 Stat. 11, 112–118, and has been in effect continuously since that time. A labor organization is an entity that is organized ''to protect and promote the interests of labor.'' *Portland Cooperative Labor Temple Association v. Commissioner*, 39 B.T.A. 450 (1939), *acq.*, 1939–1 C.B. 28. The principal purpose of the organization must be to better the working conditions of people engaged in a common pursuit. See, Treas. Reg. §1.501(c)(5)–1. Organizations meeting this requirement have traditionally engaged in collective action directed toward the workers' common objective of improving working conditions. They include labor unions that negotiate with employers on behalf of workers for improved wages, fringe benefits, hours and similar working conditions, and certain union-controlled organizations, like strike funds, that provide benefits to workers that enhance the union's ability to bargain effectively. See Rev. Rul. 67–7 (1967–1 C.B. 137). They do not include strike funds that provide income to union members but are not controlled by unions. See Rev. Rul. 76–420 (1976–2 C.B. 153). Such an organization will not pay the strike benefits ''with the objective of bettering conditions of employment, but by reason of its contractual agreements with the workers.''

Labor organizations may also meet the requirements of section 501(c)(5) by providing benefits that directly improve working conditions or compensate for unpredictable hazards that interrupt work. Examples of such benefits include operating a dispatch hall to match union members with work assignments and providing industry stewards who represent employees with grievances against management. See Rev. Rul. 75–473 (1975–2 C.B. 213); Rev. Rul. 77–5 (1977–1 C.B. 148). On the other hand, managing saving and investment plans for workers, including retirement plans, does not bear directly on working conditions. See Rev. Rul. 77–46 (1977–1 C.B. 147). Accordingly, section 501(c)(5) has not been applied to organizations that manage retirement savings plans as their principal activity.

Nevertheless, in *Morganbesser v. United States*, 984 F.2d 560 (2d Cir. 1993), the court held that a trust managing a pension benefit plan pursuant to a collective bargaining agreement qualified as a labor organization described in section 501(c)(5). The IRS and the Treasury Department believe that this decision is contrary to existing law, and the IRS is issuing an action on decision reflecting its view that the *Morganbesser* court erred in its holding. These proposed regulations are a clarification of the existing legal standard.

Like labor organizations, agricultural and horticultural organizations must also better the conditions of those engaged in a common pursuit in order to be described in section 501(c)(5). See § 1.501(c)(5)–1. There is no authority indicating that the law is to be interpreted differently for agricultural and horticultural organizations than for labor organizations. Accordingly, the proposed regulations clarify the law as it applies to all section 501(c)(5) organizations.

Certain organizations have taken the position in refund actions that they are labor organizations described in section 501(c)(5) even though their principal activity was to manage retirement savings plans for workers. In addition, some such foreign organizations have claimed exemption from withholding on dividend, interest and similar income that they have earned. The IRS will continue to oppose these claims for refund and exemption from withholding.

A health plan is not a retirement savings plan. Thus, the IRS will continue to follow Rev. Rul. 62–17

(1962–1 C.B. 87) (regarding a labor organization providing health benefits) even in circumstances where a majority of the organization's members are retired. Furthermore, the IRS will continue to recognize that negotiating the terms of a retirement plan and other postretirement benefits and designating one or more representatives to the board of a multiemployer pension trust are proper activities for a labor organization. The proposed regulations are not intended to apply to or affect any other provision of federal law, including provisions of the Employee Retirement Income Security Act of 1974 (ERISA) administered by the Secretary of Labor.

Explanation of Provisions

The proposed regulations add a new paragraph to §1.501(c)(5)–1 providing that an organization is not an organization within the meaning of section 501(c)(5) if the organization's principal activity is to manage savings or investment plans or programs, including retirement savings plans. *Proposed Effective Date* These regulations are proposed to be effective December 21, 1995.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the Federal Register.

Drafting Information

The principal author of these regulations is Robin Ehrenberg, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 continues to read in part as follows:

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

Par. 2. Section 1.501(c)(5)-1 is amended by:

1. Redesignating paragraph (b) as paragraph (c).

2. Adding a new paragraph (b) to read as follows:

§ 1.501(c)(5)–1 Labor, agricultural, and horticultural organizations.

* * * * * *

(b)(1) An organization is not an organization described in section 501(c)(5) if the principal activity of the organization is to receive, hold, invest, disburse, or otherwise manage funds associated with savings or investment plans or programs, including pension or other retirement savings plans or programs.

(2) *Example*. Trust A is organized in accordance with a collective bargaining agreement between a labor union and multiple employers. Representatives of both the employers and the union serve as trustees. Trust A receives funds from the employers who are subject to the agreement, invests the funds and uses the funds and accumulated earnings to pay pension benefits to union members as specified in the agreement. It also provides information to union members about their retirement benefits and assists them with administrative tasks associated with the benefits. Most of Trust A's activities are devoted to these functions. From time to time, Trust A also participates in the renegotiation of the collective bargaining agreement. Because Trust A's principal activity is to manage funds associated with a pension plan, it is not an organization described in section 501(c)(5).

* * * * * *

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 20, 1995, 8:45 a.m., and published in the issue of the Federal Register for December 21, 1995, 60 F.R. 66228)

Notice of Proposed Rulemaking and Notice of Public Hearing

Certain Transfers of Domestic Stock or Securities by U.S. Persons to Foreign Corporations

INTL–9–95

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In *** [T.D. 8638, page 5, this Bulletin], the IRS is issuing temporary regulations revising the rules under section 367(a) with respect to certain transfers of stock or securities of domestic corporations by United States persons pursuant to the corporate organization, reorganization or liquidation provisions of the Internal Revenue Code. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by March 25, 1996. Outlines

of topics to be discussed at the public hearing scheduled for April 11, 1996, at 10 a.m. must be received by March 21, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (INTL 0009–95), Room 5228, Internal Revenue Service, POB 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 (INTL–0009–95), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave. NW., Washington, DC. 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, Philip L. Tretiak at (202) 622-3860; concerning submissions and the hearing, Christina Vasquez at (202) 622-7180 (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 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 February 26, 1996.

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.

The collection of information is in §1.367(a)–3T(c)(4). This information is required by the IRS as a condition for a taxpayer to qualify for an exception to the general rule of taxation under section 367(a)(1). This information will be used to determine whether a taxpayer properly qualifies for a claimed exception. The respondents generally will be U.S. corporations, probably U.S. multinationals, that are acquired by foreign companies pursuant to nonrecognition exchanges or that engage in joint ventures with foreign companies. Responses to this collection of information by the relevant U.S. corporations are required in order for the shareholders of such corporations to qualify for an exception to the general rule under section 367(a)(1).

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.

Estimated total annual reporting burden: 1,000 hours. The estimated annual burden per respondent varies from 1 hour to 20 hours, depending on individual circumstances, with an estimated average of 10 hours.

Estimated number of respondents: 100.

Estimated annual frequency of responses: Once.

Background

The temporary regulations published in the *** [T.D. 8638, page 00, this Bulletin] amend the Income Tax Regulations (26 CFR part 1) relating to section 367(a). The temporary regulations contain rules relating to the transfer of stock or securities by a United States person to a foreign corporation in an exchange described in section 367(a).

The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations. Final regulations under section 367(a) regarding transfers of stock or securities will integrate the proposed regulations herein with the notice of proposed rulemaking published on August 26, 1991, in the Federal Register (56 FR 41993). Thus, the proposed regulations herein supplement and, where inconsistent with, supersede, the 1991 proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that this regulation does not have a significant impact on a substantial number of small entities. Thus, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Notice of Public Hearing

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

A public hearing has been scheduled for April 11, 1996, at 10 a.m. in the IRS Auditorium. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

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

Persons that wish to present oral comments at the hearing must submit written comments by March 25, 1996, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by March 21, 1996.

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 author of these proposed regulations is Philip L. Tretiak of the Office of Associate Chief Counsel (International), Internal Revenue Service. However, other personnel

from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income tax, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. New §1.367–9 is added to read as follows:

§1.367(a)–9 Transfers by U.S. persons of stock or securities of domestic corporations to foreign corporations.

[The text of this proposed section is the same as the text of paragraphs (a), (c), (d), (e), (f), (g)(1) and (h)(1) of §1.367–3T published elsewhere in *** [T.D. 8638, this Bulletin].]

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 22, 1995, 8:45 a.m., and published in the issue of the Federal Register for December 26, 1995, 60 F.R. 66771)

Notice 96–6

In Rev. Proc. 94–76, 1994–2 C.B. 825, the Internal Revenue Service announced that it had commenced a project to study whether certain transactions qualifying as corporate reorganizations under § 368 circumvent the purposes of *General Utilities* repeal, necessitating corrective regulations under § 337(d). The transactions under study included any transaction in which one corporation owns stock in a second corporation, the first corporation is not an ''80-percent distributee'' of the second corporation under § 337(c), and the two corporations are combined (a ''corporate combining transactions''). The IRS and the Treasury Department have decided not to issue guidance at this time regarding corporate combining transactions and are closing this project.

Rev. Proc. 94–76 and section 5.15 of Rev. Proc. 96–3, 1996–1 I.R.B. 82, state that the IRS will not issue advance rulings on the tax consequences of corporate combining transactions while the study of such transactions is being undertaken. The IRS will amplify and modify Rev. Proc. 96–3 by moving section 5.15 from section 5 (Areas Under Extensive Study) to section 3 (Areas In Which Rulings Or Determination Letters Will Not Be Issued). No inference is intended by this notice as to the tax treatment of corporate combining transactions under current law.

For further information regarding this notice, contact Keith Stanley of the Office of Assistant Chief Counsel (Corporate) at (202) 622-7530 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters.
(Also §§ 368; 1.368–1.)

Rev. Proc. 96–22

SECTION 1. PURPOSE

This revenue procedure amplifies and modifies Rev. Proc. 96–3, 1996–1 I.R.B. 82, which sets forth areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Domestic) and the Associate Chief Counsel (Employee Benefits and Exempt Organizations) relating to issues on which the Internal Revenue Service will not issue advance letter rulings or determination letters.

SECTION 2. BACKGROUND

In Rev. Proc. 94–76, 1994–2 C.B. 825, currently reflected in section 5.15 of Rev. Proc. 96–3, the IRS stated that while it was studying whether certain transactions qualifying as corporate reorganizations under § 368 circumvent the purposes of *General Utilities* repeal, the IRS would not issue advance rulings on the tax consequences of the transactions under study. In notice 96–6, the IRS announced that this study is being closed.

SECTION 3. PROCEDURE

Rev. Proc. 96–3 is amplified by adding to section 3 (Areas In Which Rulings Or Determination Letters Will Not Be Issued) the provision presently in section 5.15, and is modified by deleting the provision from section 5 (Areas Under Extensive Study).

DRAFTING INFORMATION

For further information regarding this revenue procedure, contact Keith Stanley of the Office of Assistant Chief Counsel (Corporate) at (202) 622-7530 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, § 842.)

Rev. Proc. 96–23

SECTION 1. PURPOSE

This revenue procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under § 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 1994. Instructions are provided for computing foreign insurance companies' liabilities for the estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 1994. For more specific guidance regarding the computation of the amount of net investment income to be included by a foreign insurance company on its U.S. income tax return, see Notice 89–96, 1989–2 C.B. 417. For the domestic asset/liability percentage and domestic investment yield, as well as instructions for computing foreign insurance companies' liabilities for estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 1993, see Rev. Proc. 95–26, 1995–1 C.B. 703.

SEC. 2. CHANGES.

.01 DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 1995. The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 1994, the relevant domestic asset/liability percentages are:

114.7 percent for foreign life insurance companies, and

165.8 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 1995. The Secretary is required to prescribe separate domestic investment yields for foreign life insurance companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 1994, the relevant domestic investment yields are:

8.4 percent for foreign life insurance companies, and

6.4 percent for foreign property and liability insurance companies.

The domestic investment yields provided in this revenue procedure are based on tax return data rather than NAIC statement data.

SEC. 3. APPLICATION—ESTIMATED TAXES

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 1994, a foreign insurance company must compute its estimated tax payments by adding to its

income other than net investment income the greater of (i) its net investment income as determined under § 842(b)(5) that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under § 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the release of this revenue procedure, the domestic asset/liability percentages and the domestic investment yields provided in this revenue procedure must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this revenue procedure is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Rev. Proc. 95–26 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89–96.

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 1994.

SEC. 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Mary Gillmarten of the Office of the Associate Chief Counsel (International). For further information about this revenue procedure, please contact Ms. Gillmarten at (202) 622-3870 (not a toll free call), or write to the Internal Revenue Service, Office of the Associate Chief Counsel (International), 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:INTL:Br.5, Room 4562.

General Rules for Filing and Specifications for the Private Printing of Substitute Forms W–2 and W–3

26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6011, 6041, 6051, 6071, 6081, 6091; 1.6041–1, 1.6041–2, 31.6051–1, 31.6051–2, 31.6071(a)–1, 31.6081(a)–1.)

Rev. Proc. 96–24

PART A. GENERAL

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to provide the general rules for filing and to state the requirements of the Internal Revenue Service (IRS) and the Social Security Administration (SSA) for reproducing paper substitutes for Form W–2, Wage and Tax Statement, and Form W–3, Transmittal of Wage and Tax Statements, for amounts paid during the 1996 calendar year. The information reported on Forms W–2 and W–3 is required to establish tax liability for employees and their eligibility for Social Security and Medicare benefits.

.02 Forms W–2 and W–3 have only minor changes for 1996. Please see ''Nature of Changes'' (Section 2, below) and the exhibits at the end of this revenue procedure for changes to the Form W–2 and W–3.

.03 For the purpose of this revenue procedure, a substitute form is one that is not printed by IRS. **A substitute Form W–2 or W–3 MUST conform to the specifications in this revenue procedure to be acceptable to the IRS.** Preparers should also refer to the separate instructions for Forms W–2 and the instructions on Form W–3 for details on how to complete these forms. See Part C, Sec. 4.01, for information on ordering the official IRS forms and instructions. See Part B, Sec. 2, for requirements for substitute forms furnished to employees.

.04 IRS has instituted a centralized call site to answer questions related to information returns (Forms W–2, W–3, 1099, etc.). The call-site phone number is 304-263-8700 **(not a toll-free number)**. The number for Telecommunication Device for the Deaf (TDD) is 304-267-3367 **(not a toll-free number)**.

.05 IRS has established a personal computer based Information Reporting Program Bulletin Board System (IRP–BBS) at the IRS Martinsburg Computing Center (IRS/MCC). This system provides access to the forms and publications relating to information returns, news of the latest changes, the ability to receive answers to specific questions, access to shareware, and other features. The IRP–BBS is available for public use and can be reached by dialing 304-264-7070 **(not a toll-free number)**. The IRP–BBS is compatible with most modems. For more information concerning this system, call IRS/MCC at 304-263-8700 **(not a toll-free number)**.

.06 Employers are reminded that under Section 6722 of the Internal Revenue Code (IRC) they can be assessed a penalty of $50 per Form W–2 that is not furnished to an employee on a form acceptable to the IRS (up to $100,000). To be acceptable to IRS, the Form W–2 must be either the ''official'' form or a substitute form with the core data placed exactly as specified in Part B., Section 2.04 of this Revenue Procedure. No IRS office is authorized to allow deviations from this Revenue Procedure.

.07 This revenue procedure supersedes Rev. Proc. 95–20, 1995–13 I.R.B. (Reprinted as Publication 1141, Revised 3–95).

SEC. 2. NATURE OF CHANGES

.01 The text and exhibits were updated for tax year 1996.

.02 **Only 7 inch width Forms W–2 and W–3 are acceptable for SSA processing. The exhibits for the printing of 7½ and 8 inch width Forms W–2 and W–3 have been removed because 7.5 and 8 inch forms cannot be put through SSA scanning equipment. Keying from the paper documents will be necessary for any 7.5 and 8 inch forms submitted to SSA.**

.03 **A barcode is now required for copies B, C, and 2 of Forms W–2 (see Part B, Section 2.02 below).**

.04 Any questions pertaining to Copy A of Form W–2 should be submitted to SSA. Questions regarding Copies B, C, and 2, should be submitted to IRS (see Part B, Section 3.01 below).

.05 A change in the SSA address to which Form W–2, Copy A, should be submitted has been added. Also, a new zip code has been added for those employers submitting Form W–2, copy A by certified mail. The use of a different zip code will allow SSA to better handle filings by certified mail (see Part B,Section 1.10 below).

.06 The words For Paperwork Reduction Act Notice, see separate instructions,'' must be printed in red OCR drop-out ink on Forms W–2, Copy A.

.07 The form number and title must be printed in red OCR drop-out ink on

Form W–2, Copy A, and Form W–3. The tax year should remain printed in black ink.

.08 Military employers are now required to report basic quarters, subsistence allowances, and combat pay provided to their employees in box 13 of Form W–2 using code Q.

.09 Information has been added recommending that if employment terminated before December 31, 1996, that the employee receive a copy of their W–2 any time after employment ends. Also, if the employee requests their Form W–2 it should be given within 30 days of the request or the final wage payment, whichever is later. If the business closes, Copy ''A'' of the Form W–2 may be filed with the Social Security Administration as soon as they are completed. It is not necessary to wait until January 1 of the following year (see Part A, section 3.06 below).

.10 **The Catalog Number, shown on the 1996 Form W–2 as "Cat. No. 10134D", and the Catalog Number shown on the 1996 Form W–3 as No. 10159Y, is used for IRS distribution purposes and should not be printed on substitute Forms W–3 or W–2 (Copy A or employee copies).**

.11 Various editorial changes were made.

SEC. 3. GENERAL RULES FOR FILING FORMS W–2

.01 Employers MUST use magnetic media for filing with SSA if they prepare and file 250 or more 1996 Forms W–2 (Copy A). This requirement applies unless:

1 The employer can establish that filing on magnetic media will result in undue hardship, **AND**

2 The employer is granted a waiver of the requirement by IRS.

To request a waiver of the magnetic media filing requirement, for the current tax year only, submit Form 8508, *Request for Waiver From Filing Information Returns on Magnetic Media*, to:

If by Postal Service:
Internal Revenue Service
Martinsburg Computing Center
P.O. Box 1359
Martinsburg, WV 25401–1359
Or, if by truck or air freight:
IRS—Martinsburg Computing Center
Magnetic Media Reporting
Route 9 and Needy Road
Martinsburg, WV 25401.

Forms may also be FAXED to the IRS/MCC at (304) 264-5602.

Form 8508 may be obtained by calling 1-800-829-3676. Form 8508 also may be obtained directly from the IRS Martinsburg Computing Center (IRS/MCC) at the above address or by calling 304-263-8700 (not a toll-free number). The number for Telecommunication Device for the Deaf (TDD) is 304-267-3367 (not a toll-free number). It is recommended that completed requests for waivers (Form 8508) be submitted at least 45 days before but no later than the due date of the return (see Sec. 3.06, below). The requestor will receive an approval or denial letter from IRS, but must allow at least **30** days for IRS to respond. If you have any questions concerning Form 8508, contact IRS/MCC at the address or phone number shown above. Employers who do not comply with the magnetic media filing requirements for Form W–2 and who are not granted a waiver may be subject to certain penalties. Since many states and local governments accept Form W–2 data on magnetic media, savings may be obtained if magnetic media is used for filing with both SSA and state or local governments. In many instances, the state or local government is willing to accept the data format specifications set out in SSA's Technical Instruction Bulletin No. 4, Magnetic Media Reporting. You must contact each individual state or local taxing agency to receive approval and make arrangements to file on magnetic media.

EMPLOYERS WHO FILE FORM W–2 INFORMATION ON MAGNETIC MEDIA WITH SSA MUST NOT SEND THE SAME DATA TO SSA ON PAPER FORMS W–2. This would result in duplicate reporting and may subject the filer to penalties imposed by the IRS.

.02 TIB–4, *Magnetic Media Reporting, Submitting Annual W–2 Copy A Information to the Social Security Administration*, (SSA Pub. No. 42–007, revised Oct., 1995) contains the specifications and procedures for filing Form W–2 information on magnetic media with SSA. Specifications for both tape and diskette reporting for Forms W–2 are included in this Technical Instructions Bulletin (TIB–4).

.03 TIB–4 may be obtained by writing to:

Social Security Administration
OCRO, DEA
Attn: Resubmittal Unit
300 North Greene Street
Baltimore, MD 21201.

Employers may call their local SSA Magnetic Media Coordinator (MMC) to obtain the TIB–4 (see list of Magnetic Media Coordinators' telephone numbers in the Appendix). The TIB–4 is also on the SSA Annual Wage Reporting Bulletin Board System/AWRBBS. The number for the AWRBBS is (410) 965–1133 (not a toll-free number). Employers using magnetic media are cautioned to obtain the most recent revision of the TIB–4 *and supplements* due to possible changes in the specifications and procedures.

.04 Employers not using magnetic media must file a paper Copy A of Form W–2 with SSA on either the IRS printed official form or a privately printed substitute paper form that exactly meets the specifications shown in Parts B and C.

.05 Employers can design their own statements to give to employees. This applies to both employers who file with SSA either on magnetic media or paper Forms W–2, Copy A. Employee statements designed by employers *must* comply with the requirements shown in Parts B and C, below.

NOTE: Copy A must not be filed on paper with SSA when the same Form W–2 information is filed on magnetic media. Therefore, magnetic media filers who use the official IRS printed form or any other pre-printed form are advised not to print Copy A, or to discard a printed Copy A, to prevent duplicate information from being submitted to SSA.

.06 1996 Forms W–2, whether filed on magnetic media or paper, must be submitted to SSA on or before February 28, 1997. In addition, the employee copies must be furnished to the employee on or before January 31, 1997. If employment ended before December 31, 1996, the employee may be furnished their copy any time after employment ends. However, If the employee requests Form W–2, you must furnish him or her the completed copies within 30 days of the request or the final wage payment, whichever is later. This requirement is met if the form is properly addressed, mailed, and postmarked on or before the due date. If the business closes, Copy A of the Form W–2 may be filed with the Social Security Administration as soon as they

are completed. It is not necessary to wait until after January 1st of the following year to file them. Failure to timely file with SSA or to timely provide the employee copies may subject the employer to penalties. Employers needing additional time to file Form W–2 information (paper or magnetic media) with SSA may request an extension of time to file by submitting Form 8809, *Request for Extension of Time to File Information Returns*, to the IRS/MCC at the address (or alternative address) listed in Sec. 3.01, above. The extension request should be filed as early as possible, but must be postmarked no later than the due date of the forms (February 28, 1997). Forms may be FAXED to the IRS/MCC at (304) 264-5602. **DO NOT SEND FORM 8809 TO SSA.**

NOTE: APPROVAL OF THE EXTENSION IS NOT AUTOMATIC. Approval or denial is based on administrative criteria and guidelines. The requestor will receive an approval or denial letter from IRS and must allow at least 30 days for IRS to respond. Form 8809 may be obtained by calling 1-800-829-3676, or by contacting IRS/MCC (See the address and phone number in Sec. 3.01, above).

.07 If requesting extensions of time for more than 10 employers, IRS encourages filers to submit the request on tape, tape cartridge, 5¼ or 3½-inch diskette, or electronically through the Information Reporting Program Bulletin Board System (IRP–BBS). Transmitters who submit requests for multiple payers will receive one approval letter with an attached list of payers covered under that approval. Publication 1220, *Specifications for Filing Forms 1098, 1099 series, 5498 and W–2G Electronically or on Magnetic Media*, provides information on how to file requests for extensions of time on tape, diskette, or electronically.

NOTE: Approval of extensions to file (disclosure of return information) will be made only to those third party filers and/or transmitters for whom IRS has received disclosure authorization.

SEC. 4. GENERAL RULES FOR FILING FORM W–3

.01 Employers submitting Forms W–2 (Copy A) on *paper* to SSA must transmit Forms W–2 with Form W–3.

.02 Form W–3 must be the same width (7 inches) as the Forms W–2 filed.

.03 Form W–3 should only be used to transmit paper Forms W–2 (Copy A). Magnetic media filers do not file Form W–3. Employers using magnetic media must transmit Form W–2 data with Form 6559, *Transmitter Report and Summary of Magnetic Media*, (and Form 6559–A, *Continuation Sheet for Form 6559*, if necessary). These forms may be obtained by calling either your SSA MMC (see listing in Appendix) or IRS at 1-800-829-3676.

PART B. REQUIREMENTS FOR FILING PAPER SUBSTITUTES

SEC. 1. REQUIREMENTS FOR SUBSTITUTE "PRIVATELY PRINTED" FORMS SUBMITTED TO SSA (FORMS W–2, COPY A, AND FORMS W–3)

.01 Employers may file privately printed substitute Forms W–2 and W–3 with SSA. The substitute form must be an exact replica of the IRS printed form (or official reproduction proof) with respect to layout and contents because it will be read by machine. The dimensions of a substitute form may differ as far as width (see Sec. 1.05, below). The Government Printing Office (GPO) symbol must be deleted (see Sec. 1.16, below). The specifications and allowable tolerances for the Copy A of substitute Forms W–2 are provided later in this Revenue Procedure. See Exhibit A for Form W–2 specifications. The specifications for Forms W–3 are provided in Exhibit B.

.02 Paper for substitute Forms W–2, Copy A, and Form W–3 (cut sheets and continuous pinfeed forms) that are to be filed with SSA must be white 100% bleached chemical wood, **18–20 pound paper only,** optical character recognition (OCR) bond produced in accordance with the specifications shown as follows:

Paper Requirements

1	Acidity: pH value, average, not less than	4.5
2	Basis Weight 17 × 22 500 cut sheets	18–20
	Metric equivalent grams per. sq. meter	60–75
	A tolerance of ±5 pct. shall be allowed.	
3	Stiffness: Average, each direction, not less than Gurley milligrams—	
	Cross direction	50
	Machine direction	80
4	Tearing Strength: Average, each direction, not less than— Grams	40
5	Opacity: Average, not less than—Percent	82
6	Reflectivity: Average not less than—percent	68
7	Thickness: Average	inch 0.0038
	Metric equivalent	mm 0.097
	A tolerance of ±0.0005 inch (0.0127mm) shall be allowed. Paper shall not vary more than 0.0004 inch (0.012mm) from one edge to the other.	
8	Porosity: Average, not less than—seconds	10
9	Finish (smoothness): Average, each side—seconds	20–55
	(For information only, the Sheffield equivalent unit	170–d100
10	Dirt: Average, each side, not to exceed—Parts per million	8

NOTE: Reclaimed fiber in any percentage is permitted, provided the requirements of this standard are met. **DO NOT USE RECYCLED PAPER.**

.03 All printing for Copy A (of Forms W–2) and Form W–3 will be in red OCR dropout ink, as specified below, except for the form identifying numbers '22222' or '33333' at the top of the form and the descriptive information at the bottom (see Exhibits C and D) that will be printed in nonreflective black ink. All other printing will be in red OCR dropout ink meeting, or comparable to, the specifications in this paragraph. The OCR dropout ink for paper Forms W–2, Copy A, and W–3 is specified as Flint Ink (formerly Sinclair and Valentine) J-6983 red ink or equivalent. This is the same ink that is used for Copy A of the Form 1099 series. The use of this is required for 1996 Forms W–3 and W–2, Copy A.

NOTE: Printing in any other red OCR dropout ink must be cleared by contact-

ing Banc-Tech Corp., Attn: Forms Designer & Analyst, P.O. Box 660204, MS-77, Dallas, TX 75266 (214-579-6927—This is a voice mail number. Leave a message and your call will be returned).

.04 Type must be substantially identical in size and shape with corresponding type on the official form. The form identifying number MUST be printed in black ink using an OCRA font; 10 characters per inch.

1 On Form W–3 and Copy A of Forms W–2, all the perimeter rules must be 1-point (0.014 inch), while all other rules must be one-half point (0.007 inch).

2 Vertical rules must be parallel to the left edge of the form; horizontal rules parallel to the top edge.

.05 Two official Forms W–2 (Copy A), or one official Form W–3 are contained on a single page that is 7 inches wide (exclusive of any snap-stubs) by 11 inches deep. The form identifying number for the official forms (7 inches wide) is '22222' (5 digits) for Form W–2 and '33333' (5 digits) for Form W–3. The top margin for 1996 Forms W–3 and W–2, Copy A is .375 inch (3/8 inch). The right margin must be .15 inch and the left margin .35 inch (plus or minus .0313 inch). The margins are unchanged from 1995. Margins must be free of all printing. For Forms W–2, Copy A, the combination width of Box 1, ''Control number'', and the box containing the form identifying number (22222) must always be 2.0 inches. For Form W–3, the combined width of these boxes must always be 2.2 inches.

NOTE: All form identifying numbers are to be printed in black ink, using OCRA font, printed 10 characters per inch.

.06 The depth of the individual image on a page must be the same as that of the IRS printed forms. For Form W–2, the depth is 5.5 inches (see Exhibit A). The depths of the Form W–3 on a page must be 4.4 inches (see Exhibit B).

.07 The words *''Do NOT Cut or Separate Forms on This Page''* must be printed in red OCR dropout ink between the two Forms W–2 on Copy A only (see Exhibit A). Perforations are required on all copies (except Copy A) to enable the separation of individual forms. Continuous pinfeed copy A forms must be separated at the page perforation into individual 11 ''deep pages before submission to SSA. The pinfeed strips must also be removed. However, the two W–2 documents contained on the 11'' deep page *must not* be separated.

.08 The words **"For Paperwork Reduction Act Notice, see separate instructions",** *must* be printed in red OCR drop-out ink on Forms W–2, Copy A (see Exhibit A for format and location).

.09 The Office of Management and Budget (OMB) Number *must* be printed on *each* ply of Form W–2 and W–3 (see Exhibits A and B for format and location).

.10 The statement *''Please return this entire page with the accompanying Forms W–2 to the* **Social Security Administration, Data Operations Center, Wilkes-Barre, PA. 18769-0001**. If you use certified mail to file, change the zip code to ''18769-0002.'' Household employers filing Forms W–2 for household employees should send the forms to the **same address shown above**.

.11 The Paperwork Reduction Act Notice must be printed on Form W–3 (see Exhibit B for format and location).

.12 *Privately printed continuous substitute Forms W–2, Copy A, must be perforated at each 11'' page depth. No perforations are allowed between the individual forms (5½ inch Forms W–2) on a single copy page of Copy A.* Continuous pinfeed Copy A forms must be separated at the page perforation prior to submitting them to SSA. Two Copy A forms are contained on one page. The two copies must remain together on the page. Only the pages are to be separated (burst). Perforations are required between all the other *individual* copies on a page (Copies 1, B, C, 2, and D) included in the set.

.13 The back of a substitute Form W–2, Copy A, and Form W–3 (page 1) must be free of all printing.

.14 Spot carbons are *NOT permitted* for Copy A of Forms W–2 or for Form W–3. Interleaved carbon should be black and must be of good quality to assure legibility of information on all copies and to preclude smudging.

.15 Chemical transfer paper is permitted for Form W–2, Copy A, and Form W–3 only if the following standards are met:

1 Only *chemically backed* paper is acceptable for Copy A.

2 Carbon coated forms *are not* permitted. Front and back chemically treated paper cannot be processed properly by machine.

3 Chemically transferred images must be black in color.

.16 The GPO symbol must not be placed on substitute Copy A of Forms W–2.

.17 The Catalog Number, shown on the 199**6** Form W–2 as ''Cat. No. **10134D**'', and the Catalog Number shown on the 1996 Form W–3 as ''Cat. No. **10159Y**'', is used for IRS distribution purposes and should not be printed on substitute forms.

SEC. 2. REQUIREMENTS FOR SUBSTITUTE FORMS FURNISHED TO EMPLOYEES (COPIES B, C, AND 2 OF FORMS W–2)

.01 All employers (including those who file on magnetic media and do not file a paper Copy A) must furnish employees with at least two copies of the Forms W–2 (three or more for employees required to file a state, city, or local income tax return). The dimensions of these copies (Copies B, C, etc.) but not copy A, may be expanded from the dimensions of the official form to allow space for conveying additional information, such as additional entries required for Boxes 13 or 14, withholding from pay for health insurance, union dues, bonds, charity, etc. The requirement that a maximum of three items are permitted in Box 13 of Form W–2 applies only to the paper Copy A that is filed with SSA. As long as sufficient space is provided on the substitute employee copies, as many items as needed may be placed in Box 13 or box 14. Also, on these copies (Copies B, C, etc.), the size of these boxes may be adjusted. (However, see the minimum sizes for certain boxes, below). This may permit the employer to eliminate other statements or notices that would otherwise be furnished to employees.

1 The MAXIMUM allowable dimensions for employee copies of Forms W–2 are:

(a) depth should be no more than 6.5 inches;

(b) width should be no more than 8.5 inches.

2 The MINIMUM allowable dimensions for employee copies of Forms W–2 are:

(a) 2.67 inches by 5.0 inches.

(b) horizontal or vertical format is permitted.

NOTE: These minimum and maximum size specifications are for 1996 only and may change for future years. The maximum width of 8.5 inches is for employee copies of Form W–2 only. The width of the paper Copy A, submitted to SSA, is specified in Part B, section 1.05 above.

.02 Beginning in 1996, a barcode is required for copies B,C, and 2 of Forms W–2. This barcode will be electronically imaged on a Kodak I923 scanner and read by software developed for IRS by Loral Federal Systems. This three digit barcode will identify the form as a 1996 Form W–2. The 5 WA designation is to be shown at the bottom from the left to the center of the form in a 3 of 9 format printed in black ink with a density of 3.9 characters per inch and .4 inch high. Allow at least .125 inch unprinted area on all four sides of the barcode. IRS expects a variation in width of the barcode depending upon the type of output device being used. However, we expect the quality of the output device to produce legible print for both the barcode and the information entered on the forms (see Exhibit E).

.03 The paper for all copies should be white. The substitute Copy B (or its equal), that employees are instructed to attach to their Federal income tax return, must be at least 12 pound paper (basis 17 × 22–500), while the other copies furnished the employee should be at least 9-pound paper (basis 17 × 22–500).

.04 Interleaved carbon and chemical transfer paper for employee copies must meet the following standards:

1 All copies must be CLEARLY LEGIBLE;

2 All copies must have the capability to be photocopied; and

3 Fading must not be of such a degree as to preclude legibility and the ability to photocopy.

In general, black chemical transfer inks are preferred; other colors are permitted only if the above standards are met. ''Spot carbons'' are NOT permitted (See Part B Sec. 1.15, above, for standards for chemical transfer paper for Copy A.)

.05 The following requirements govern the private printing of employee copies of Forms W–2. All substitutes must be a form, which contains boxes, box numbers, and box titles that, where applicable, match the IRS printed form. The placement, numbering, and size of certain boxes (the ''core'' information) is specified as follows:

1 The items and box numbers that constitute the core data are:

Box 1—Wages, tips, other compensation,

Box 2—Federal income tax withheld,

Box 3—Social Security Wages/ Railroad Retirement Compensation,

Box 4—Social Security tax withheld/ Railroad Retirement Tax Withheld,

Box 5—Medicare wages and tips/ Railroad Retirement Tips, and

Box 6—Medicare tax withheld/ Railroad Retirement Tax Withheld.

NOTE: Railroad employees may not be subject to Social Security coverage but are subject to Railroad Retirement Tax Tier I and II coverage. Railroad Compensation employers may make the above modifications to Forms W–2 but only for substitute Forms W–2 furnished to employees and *not* for any Copy A forms to be filed with SSA. The ''core'' boxes **must** be printed in the exact order on each line as on the IRS printed form (see the Exhibits at the end of this revenue procedure). Boxes 1 and 2 must be next to each other, with Boxes 3 and 4 below on the next line, and Boxes 5 and 6 on the line below Boxes 3 and 4.

2 The block of core data (Boxes 1 through 6) must be placed in the upper right of the form. Substitute employee copies of Form W–2, which are printed using a vertical format with dimensions smaller than the IRS printed form, may have the core data entirely on the top of the form (see Exhibit F). In no instance will boxes or other information be permitted to the right of the core data. Standard margins or a small amount of other blank space may appear to the top or right of this data. The form title, number, or copy (Copy B, C, etc.) may be at the top of the form. Also, a reversed or blocked-out area to accommodate a postal permit number or other postal considerations is permitted at the upper right of the form.

3 Boxes 1 through 6 must each be a minimum of 1⅜ inches wide and ¼ inch deep.

4 Other required boxes:

— Employer identification number (EIN),

— Employer's name, address, and ZIP code,

— Employee's Social Security number, and

— Employee's name, address, and ZIP code.

These items are required to be present on the form and must be in boxes similar to those on the IRS printed form. However, they may be placed in any location, other than the top or upper right. The lettering system used on the IRS printed form (''a'' through ''f'') need not be used. The employer's EIN may be included in the box for the employer's name and address. If this is done, a separate box for the EIN is not required. The Control number box (Box ''a'' on the IRS printed form) is not required.

5 The Tax Year (1996) **MUST** be clearly printed on all copies of substitute Forms W–2. It is recommended (but not required) that this information be located to the right of the form title on the lower left of the Form W–2.

6 If applicable, Social Security tips **MUST** be shown separately from Social Security wages. A separate box is not required unless Social Security tips are to be reported.

Boxes 1 and 2 on Copy B are required to be outlined in bold 2-point rule (see Exhibit E) or highlighted in some manner to distinguish these boxes.

7 If a box for Advance EIC (Earned Income Credit) payments (Box 9) is present, the box must be outlined in bold 2-point rule or highlighted in some manner to distinguish this box. However, if no amounts are paid for Advance EIC, this box is not required and may be omitted by printers. Do not use Box 9 for any other purpose than reporting Advance EIC payments.

8 If Allocated tips (Box 8) are being reported for the individual employee (or class of employees that are being provided Forms W–2), it is recommended (but not required) that this box also be outlined in bold 2-point rule or highlighted on Copy B. However, if allocated tips are not being reported, this box may be omitted by printers.

9 If Form W–2 contains additional data concerning payroll deductions (*e.g.*, saving bonds withholding, retirement withholding, or payroll savings), there should be a special highlighting of the areas pertaining to Federal income tax withheld; wages, tips, and

other compensation; or Advance EIC (Earned Income Credit) payments that are related to those items.

10 Employers who are required to report or withhold state income tax information are required to include the following boxes on substitute Forms W–2:

Box 16—State and Employer's state identification (I.D.) number,

Box 17—State wages, tips, etc., and

Box 18—State income tax withheld.

11 Employers who are required to report or withhold local income tax information are required to include the following boxes on substitute Forms W–2:

Box 19—Locality name

Box 20—Local wages, tips, etc., and

Box 21—Local income tax.

12 If state or local tax information is required, this information is also considered ''core data.'' The state and local information **MUST** be placed at the bottom of the form. See the exhibits at the end of this revenue procedure.

13 Other boxes on the IRS printed form (Boxes 7 through 15) need not appear on substitute Forms W–2 provided to employees **unless** an employer has that item of information to report to an employee. For example, if an employee did not have Social Security tips (Box 7), Allocated tips (Box 8), or Advance EIC payments (Box 9), the form could be printed without these boxes. However, if the employer had provided amounts for dependent care benefits, those amounts would be required to be reported separately and shown in a box labeled ''Box 10, Dependent care benefits,'' as on the IRS printed form and the exhibits in this revenue procedure.

14 Employers may use other headings for Boxes 13 and 14 as needed. For example, if an employer will only be reporting amounts for a 401(k) type retirement plan in Box 13, the employee copies of Form W–2 may be printed labeling Box 13 as ''401(k) Plan.'' Also, if an employer had two items that may be reported in Box 13, they may divide the box into ''Box 13a'' and ''Box 13b,'' labeling the boxes as appropriate. This applies only to Boxes 13 and 14.

NOTE: If you are a military employer and provide your employee with basic quarters, subsistence allowances, and combat pay, report the amount in box 13 using code Q.

.06 Substitute forms for employees (Copies B, C, and 2 of Forms W–2) must meet the following requirements:

1 All copies of Forms W–2 must clearly show the form number, the form title, and the tax year. The title of Form W–2 is ''Wage and Tax Statement.'' It is recommended (but not required) that this be located on the bottom left of Form W–2. The reference to the Department of the Treasury—Internal Revenue Service must be on all copies of Form W–2 provided to the employee. It is recommended (but not required) that this be located on the bottom right of Form W–2.

2 If the substitute forms are *not labeled* as to the disposition of the copies, then written notification must be provided to each employee as specified below:

(a) The first copy of the form (Copy B) is filed with the employee's Federal tax return.

(b) The second copy of the form (Copy C) is for the employee's records.

(c) If applicable, the third copy (Copy 2) of the form is filed with the employee's state, city, or local income tax return.

3 If the substitute forms are *labeled*, the forms must contain the applicable description:

''Copy B, to be filed with employee's Federal tax return,'' **and** ''Copy C, for employee's records,'' it is recommended (but not required) that this be located on the lower left of Form W–2. The designation ''Form W–2, it is recommended (but not required) that this be located on the lower left of Form W–2 and Department of the Treasury—Internal Revenue Service.'' It is recommended (but not required) that this be located on the lower right of Form W–2.

4 Instructions similar to those contained on the back of Copy C of the official form MUST be provided to each employee. While employers may modify or delete certain information in these instructions, (such as modification for employees of railroad to cover Railroad Retirement Tier I and II Compensation and Taxes) the instructions **MUST** include the exact language concerning the Earned Income Credit (EIC) as is contained on the official form. Employers are allowed to delete information in these instructions (except the EIC explanation) that do not apply to the employee. For example, if none of the employees have dependent care benefits (Box 10), the employer may delete the instructions for that item. Also, if an employer will only be reporting amounts for a 401(k) plan in Box 13, those instructions may be modified to cover only Section 401(k) contributions.

NOTE: Printers are cautioned that the rules set forth here (Part B. Sec. 2) apply to employee copies (Copies B, C, etc.) only. Paper filers who send Copy A of Form W–2 to SSA *must* follow the requirements in Part B. Sec. 3, below for those paper submissions.

SEC. 3. GENERAL RULES FOR FILING "PAPER SUBSTITUTES" FOR FORMS W–2 AND W–3

.01 Paper substitutes that conform totally to the specifications contained in this revenue procedure may be privately printed without the prior approval of the IRS. Penalties may be assessed for not complying with the form specifications set forth in this publication. SUBSTITUTE FORMS THAT DO NOT CONFORM TOTALLY TO THESE SPECIFICATIONS ARE NOT ACCEPTABLE. This applies to both paper substitutes that are filed with SSA and those that are given to employees. **Substitute Copy A of Form W–2 and Form W–3 may be submitted to IRS and SSA for review. Forms should *not* be submitted to IRS or SSA for specific approval.** However, if you are uncertain of any specification set forth herein and want that specification clarified, you may submit a letter citing the specification in question, your interpretation of that specification, and an example of how the form would appear if produced using your understanding of the specification. Any questions pertaining to Copies B, C, and 2 of Forms W–2 should be sent to:

Internal Revenue Service
ATTN: Substitute Form W–2 Coordinator
CP:CO:SC: A Room 7238
1111 Constitution Avenue, N.W.
Washington, DC 20224

Any questions pertaining to Copy A, Form W–2, and Form W–3 should be forwarded to:

Social Security Administration
Data Operations Center

1150 E. Mountain Drive
Wilkes-Barre, PA 18702-7997
Attn: Phylis Passetti

NOTE: You should allow at least 30 days for the IRS and SSA to respond.

.02 Forms W–2 and W–3 are subject to annual review and possible change. Employers are cautioned against overstocking supplies of privately printed substitutes.

.03 Copies of the current year, IRS printed Forms W–2 and W–3 and the instructions for these forms may be obtained from most IRS offices or by calling 1-800-829-3676. The IRS provides only cut sheet sets. Reproduction proofs of the official Forms W–2 and W–3 are also available. See Part C, Sec. 4, below, for information on ordering reproduction proofs.

.04 Substitute Forms W–2 and W–3 transmitted to SSA should generally contain only data that is required by the Form W–2, the Form W–2 instructions, and this Revenue Procedure.

.05 Substitute Forms W–2, Copy A, and W–3 are machine imaged and scanned by Social Security, therefore these forms must meet the same specifications as Forms W–2 and W–3 produced by IRS. The vertical and horizontal spacing for all Federal payment and data boxes on Form W–2 must be in compliance with the specifications contained herein.

.06 All ballot boxes on Forms W–2, Copy A (Box 15), and W–3 (Box ''b'') must be 8-point boxes.

NOTE: If a box is marked, more than 50% of the applicable ballot box must be covered by an ''X''.

.07 Copy A of Form W–2 and Form W–3 must have the form producer's EIN entered to the left of ''Department of Treasury''.

PART C. ADDITIONAL INSTRUCTIONS

SEC. 1. INSTRUCTIONS FOR FORMS PRINTERS

.01 Except as provided below, if magnetic media is not used for filing with SSA, the substitute copies of Forms W–2 assembly should be arranged in the same order as the IRS printed Forms W–2. Copy A should be first, followed sequentially by perforated sets (Copies 1, B, C, 2, and D). The substitute form to be filed by the employer with SSA must carry the designation ''Copy A.''

NOTE: Magnetic media filers do not submit Copy A of Form W–2 or Form W–3. Form 6559 is the transmittal for magnetic media filed Form W–2 data.

1 It is not a requirement that privately printed substitute forms contain a copy to be retained by employers (Copy D). However, employers must be prepared to verify or duplicate this information if it is requested by the IRS or SSA. Paper filers that do not keep Copy D should be able to generate a facsimile of Copy A in case of loss.

2 Except as provided in the arrangement of the official assemblies, additional copies that may be prepared by employers shall not be placed ahead of the copy ''For EMPLOYEE'S RECORDS,'' Form W–2 (Copy C).

3 Instructions similar to those contained on the back of Copy C of the official form MUST be provided to each employee. These instructions may be printed on the back of the substitute Copy C or may be provided to employees on a separate statement. Do not print these instructions on the back of Copy B (filed with the employee's Federal income tax return) or the copy that is to be filed with the employee's state or local returns.

.02 All privately printed Forms W–2 (Copy A) must have the tax year, form number, and form title printed on the bottom face of each form using identical type to that of the official format. **Only the form number and title must be printed in red OCR drop-out ink. The tax year should remain printed in black ink. This requirement also applies to Form W–3.**

.03 The substitute Form W–2, Copy B, which employees attach to their Federal income tax return, must be at least 12-pound paper (basis 17 × 22–500) while the other copies furnished to employee's should be at least 9-pound paper (basis 17 × 22–500).

.04 Employee copies of Forms W–2 (Copies B, C, etc.), including those that are printed on a single sheet of paper, **MUST** be produced so as to be easily separated by the employee. Perforations between the individual copies that are printed on a single sheet of paper satisfy this requirement.

.05 The Form W–2, Copy A, and the OCR bond Form W–3 that are filed with SSA must have no printing on the reverse side.

.06 Instructions similar to those provided as part of the official form must be provided as part of any substitute Form W–3.

.07 All privately printed Forms W–3 must have the tax year, form number, and form title printed on the bottom face of each substitute Form W–3, using identical type to that of the official format.

.08 The copy of the substitute Form W–3 that contains the instructions and is to be retained by the employer should be at least 18-pound paper (basis 17 × 22–500).

SEC. 2. INSTRUCTIONS FOR EMPLOYERS

.01 Only originals or ribbon copies of Copy A (Forms W–2) and Form W–3 may be filed with SSA. *Carbon copies and photocopies are not acceptable.*

.02 Employers should type or machine print entries on forms whenever possible and provide good quality data entries by using a high quality type face, inserting data in the middle of blocks that are well separated from other printing and guidelines, and taking any other measures that will guarantee clear, sharp images. The employer must provide a machine scannable form for Copy A. The employer must also provide payee copies (Copies B, C, and 2) that are legible and capable of being photocopied (by the employee).

.03 The Employer Identification Number (EIN) may be entered in the Employer's name and address box on Copy A of Forms W–2 (Box ''c'' on the IRS printed Form W–2). If this is done, the EIN need not be entered in the box provided for the EIN (Box ''b'' on the IRS printed Form W–2). The EIN must be entered in Box ''e'' of the Form W–3.

.04 The employer's name, address, and EIN may be preprinted.

.05 The optional employer's state number may be pre-printed in the employer's name, address, and ZIP code box. If this is done, the Employer's state I.D. Number section in Box 16 of Forms W–2 need not be completed, as long as the applicable state taxing authority does not object. **Please check with the appropriate state taxing authority before doing this.**

.06 Generally, an agent that has an approved Form(s) 2678, Employer Ap-

pointment of Agent, should enter its name as the employer in box c of Form W–2, and file one Form W–2. However, if the agent is acting as an agent for two or more employers, or is an employer and is acting as an agent for another employer, and pays social security wages in excess of the wage base to an individual, special reporting for payments to that individual is needed. The agent should file separate Forms W–2 reflecting the wages paid by each employer. Box c of Form W–2 should include name of agent, agent for (name of employer), and address of agent. Each Form W–2 should reflect the EIN of the agent in box b. In addition the employer's EIN should be shown in box h of Form W–3.

.07 The preparation and filing instructions for Forms W–2 are contained in the 1996 Instructions for Form W–2. The preparation and filing instructions for Form W–3 are contained as part of the 199**6** Form W–3 snap set assembly.

.08 To avoid confusion and questions by employees, employers are encouraged to delete the following items from the employee copies of Forms W–2 that are provided to employees:

1 Form identifying number (*e.g.*, 22222);

2 The words ''subtotal'' and ''void'' and their boxes;

3 Any other captions or box number that would not be of any informational use to employees (unless otherwise required).

.09 Employers should use the IRS supplied label when filing form W–3 with SSA. The label should be placed inside the brackets printed in boxes ''e'' and ''f''.

SEC. 3. *OFFICE OF MANAGEMENT AND BUDGET (OMB) REQUIREMENTS FOR SUBSTITUTE FORMS*

.01 The Paperwork Reduction Act requires: (1) OMB approval of IRS tax forms, (2) that each form (all copies) show the OMB approval number and, when appropriate, the form's expiration date, and (3) that the form (or its instructions) state why IRS is collecting the information, how we will use it and whether it must be given to us. The official IRS form (or instructions) will contain this information.

.02 As it applies to substitute IRS forms, this means:

1. All substitute forms (all copies) *must* show the OMB number as it appears on the official IRS printed form (see Exhibits A and B).

2. The OMB number must be in one of the following formats:

OMB No. 1545–0008 (preferred),
or
OMB # 1545–0008

3. You must inform the users of your substitute forms of the reasons for IRS collection, use, and requirements, as stated in the instructions for the official IRS form.

Sec. 4. REPRODUCTION PROOFS

.01 The catalog for ordering reproduction proofs (repro-proofs) is mailed annually to requestors of record, and on request to other users. Tax Practitioners, tax form printers, and others wishing to obtain reproduction proofs should call the toll-free number for ordering IRS forms and publications (1-800-829-3676) and ask for Publication 1192 (**Catalog No. 60045P**), *Catalog of Reproducible Forms, Instructions and Publications*, which includes the order blank (Form 6747) for obtaining reproduction proofs. Written requests for Publication 1192 may be sent to:

Internal Revenue Service
Eastern Area Distribution Center
ATTN: Repro Coordinator
4300 Carolina Ave.
Richmond, VA 23222

.02 Publication 1192 contains item number, title, and the individual costs for each reproduction proof. Payment must be submitted with Form 6747 when requesting reproduction proofs.

.03 List of Social Security Administrations Magnetic Media Coordinators is included in the Appendix.

Sec. 5 EFFECT ON OTHER REVENUE PROCEDURES

.01 Rev. Proc. 95–20, 1995–1 C.B. 668 (Reprinted as Publication 1141, Revised **3–95**), is superseded.

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 96–6

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:

Accent on Education, Mattoon, IL

Brass Ring Society of Oklahoma, Inc., Tulsa, OK

Care Center of Kansas City, Kansas City, KS

Cassandra Manning Ballet Theatre Inc., Davenport, IA

Chicago Conservatory Society, Chicago, IL

Chicago Dodgers Youth Organization, Chicago, IL

Community Parents Reinvestment, Inc., Tampa, FL

Community Service Foundation of Bay County, Inc., Panama City, FL

Coraopolis Economic Revitalization Corporation, Caraopolis, PA

Davies Manor Association, Memphis, TN

Douglas Visions Committee, Inc., Plano, TX

Familyland Foundation, Inc., Ft. Myers, FL

Fans Field Neighborhood Development Corporation, Decator, IL

First Ozark Housing Development Corporation, Mountain Home, AR

Firstnight Inc., Villa Park, IL

First Liberty Institute Inc., Fairfax, VA

Forrestville Valley School Foundation, Forreston, IL

Fortress International Inc., Springfield, IL

Friends of the Friendless, Inc., Bronx, NY

Gold Cross Foundation, Washington, DC

Grace Lutheran Church Foundation of Grand Island Nebraska Inc., Grand Island, NE

Grace West Early Childhood Learning & Development Ctr Program Inc., Newark, NJ

Grand by Standers, Kansas City, KS

Grand Ma's Hands, Charlotte, NC

Growing Wild Over Arizona, Inc., Phoenix, AZ

Haddock Corporation, Morrisville, NC

Hand Up Society, Omah, NE

Haserv Inc., Elizabeth, NJ

Hawthorne Artistic Dance Company Inc., Jefferson City, MO

Heart to Heart Inc., Marshall, MN

Hearts in Harmony, Inc., San Antonio, TX

H E C A P, Inc., Decatur, GA

H I S Ministries Inc., Orange, TX

Hudson County Push Foundation Inc., Jersey City, NJ

Indian Business, Inc., Crandon, WI

Johnny Johnson Ministries, Inc., Louisville, KY

Junior Achievement, Eastern Shore Inc., Salisbury, MD

Junior Golf Center of St. Louis, Clayton, MO

Kankakee Eastside Jr. Football League, Kankakee, IL

Kurtz Cultural Center Incorporated, Winchester, VA

L B G I Educational Services, Chicago, IL

Leland and Lucille Strahl Educational Trust, Ashton, SD

Literacy Council of Mercer County, Sharon, PA

Love Letters Inc., Chicago, IL

Luverne Hockey Club, Luverne, MN

Magda Inc., Baltimore, MD

Main Street Keokuk Inc., Keokuk, IA

Main Street La Grange, La Grange, IL

Mark R. Pryor Foundation, Winona, MN

McDowell County Museum Commission, Inc., Kimball, WV

Mid-Atlantic Association of Ministries with Older Adults, Richmond, VA

Mildred Ford Maternity Home, Midland, TX

Missouris Young Woman of the Year, Hazel Wood, MO

Monelison Youth Football Association, Madison Heights, VA

Moss and Barnett Foundation, Minneapolis, MN

Mystery Entertainment Inc., Wheaton, MD

National Association of Professional Baseball League Sports Administration Grant Program, St. Petersburg, FL

National Drive to Cure Paralysis Inc., Baltimore, MD

National Housing Preservation Corporation, Nashville, TN

National Wellness Coalition, Washington, DC

Newark Educational Council Inc., Newark, NJ

Newton Greenway Coalition, Huntingdon Valley, PA

Nurses for Human Development Education, Inc., Jonesboro, AR

Offspring Organization Inc., Plainfield, NJ

Omega Infinity Enterprises Inc., Baltimore, MD

Oromo Support Committee Inc., Minneapolis, MN

Project Now Housing Foundation, Rock Island, IL

Ralph and Della Haskett Memorial, Jasper, AL

Ray and Rosette Doerhoff Scholarship Trust, Jefferson City, MO

Recovery Housing, Inc., Knoxville, TN

Recycling Coalition of South Dakota Inc., Sioux Falls, SD

Red Feathers Inc., Pierre, SD

Round Lake Organization of People Support, Round Lake, IL

Russell Horton Memorial Scholarship Fund, Inc., Naperville, IL

Saint Peters Church Preservation Committee, Dixon, IL

Santa Fe Jazz Foundation, Inc., Santa Fe, NM

Scott Terry and Brian Sample Scholarship Fund, Coweto, OK

Senior Care Corp., Staten Island, NY
Southeast Milwaukee Area Crime Stoppers Inc., Oak Creek, WI
Sowing Precious Seed, Kearney, MO
St. Paul-Minneapolis Adult Rehabilitation Therapy, Minneapolis, MN
Sumneytown Yoga Fellowship, Sumneytown, PA
Support Ministries, Inc., Decatur, AL
The Friends of the Birmingham Museum of Art, Birmingham, AL
The Orange Bowl Committee, Miami, FL
The Tax Information Forum Inc., Chicago, IL
Thema Literary Society, Metairie, LA
Toddlers Learning Center, Plainfield, NJ
Toledo O E S Foundation, Toledo, IA
Trasitional Services Inc., Towson, MD
Victory Jubilee Choral Arts Foundation, Washington, DC
W A C D L Foundation Inc., Milwaukee, WI
Wesser Institute of Ecology Ltd., Almond, NC
West Ellis Education Foundation Corp., West Ellis, WI
Wyoming Valley Aids Council, Wilkes-Barre, PA
Yes That's A F A C T, Richmond, VA
Youth Education Strategies, Inc., Columbus, GA
Youth Media Corporation, Kansas City, MO

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.

Deletions from Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170 of the Code

Announcement 96–7

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on 1996, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

The Children, Inc.
San Francisco, CA
Detroit Center for the Performing Arts
Grosse Point, MI
Foundation of Bowling Proprietors Association of Wisconsin, Inc.
Pewaukee, WI
Imani Corporation
Milwaukee, WI

Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organization listed below has recently filed a timely declaratory judgment suit under section 7428 of the Code, challenging revocation of its status as an eligible donee under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

Shirley Caesar Outreach Ministries, Inc.
Durham, NC
Eastern Orthodox Christian Church in America
New Albany, OH
Saint Ignatius Orthodox Church
Albany, OH
Saint Nicholas Orthodox Church
Albany, OH

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.

Numerical Finding List[1]

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[1]A cumulative list of all Revenue Rulings, Revenue Procedures, Treasury Decisions, etc., published in Internal Revenue Bulletins 1995–27 through 1995–52 will be found in Internal Revenue Bulletin 1996–1, dated January 2, 1996.

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*Denotes entry since last publication

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66–49
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[1]A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1995–27 through 1995–52 will be found in Internal Revenue Bulletin 1996–1, dated January 2, 1996.