

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.

EMPLOYEE PLANS

Notice 96-24, page 23.

Guidelines are set forth for determining for April 1996, the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for purposes of the full funding limitation of section 412(c)(7) of the Code as amended by the Omnibus Budget Reconciliation Act of 1987 and by the Uruguay Round Agreements Act (GATT).

EXCISE TAXES

T.D. 8659, page 4.

Final regulations under section 6011 of the Code relating to the gasoline and diesel fuel excise taxes.

PS-6-95, page 27.

Proposed regulations under sections 4081 and 4082 of

the Code relating to the gasoline and diesel fuel excise taxes. A public hearing will be held on June 20, 1996.

ADMINISTRATIVE

Notice 96-23, page 23.

The Service requests comments regarding the proper accounting for loans that are subject to both the principal-reduction method of accounting and the mark-to-market rules.

Rev. Proc. 96-29, page 24.

VCR and Walk-in CAP compliance programs; eligibility. This procedure describes changes to the eligibility requirements for the Voluntary Compliance Resolution Program and the Walk-in Closing Agreement Program. Rev. Proc. 94-16 and Rev. Proc. 94-62 modified.

Announcement 96-24, page 30.

Proposed examination guidelines for rural electric cooperatives are published for public comment.

Finding Lists begin on page 54.

Announcement of Disbarments and Suspensions begins on page 51.

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 Miscellaneous.

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

Part IV.—Items of General Interest.

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

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

The 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.

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

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

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

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

26 CFR 40.6011(a)-1: Returns

T.D. 8659

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 40, 42, 48, and 602

Gasoline and Diesel Fuel Excise Tax; Registration Requirements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the taxes on gasoline and diesel fuel. This document also removes obsolete excise tax regulations. The regulations reflect and implement certain changes made by the Omnibus Budget Reconciliation Act of 1990 and the Omnibus Budget Reconciliation Act of 1993 (the 1993 Act). The regulations affect certain blenders, enterers, industrial users, refiners, terminal operators, and throughputters. The regulations also affect certain persons that sell, buy, or use diesel fuel for a nontaxable use.

EFFECTIVE DATE: These regulations are effective March 14, 1996.

FOR FURTHER INFORMATION CONTACT: Frank Boland (202) 622-3130 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1418. Responses to this collection of information are mandatory and are required to obtain certain credits or payments.

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 estimated average annual reporting burden per respondent is .1 hour.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books and records relating to this 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

The diesel fuel regulations. Before 1994, the diesel fuel tax applied to sales of diesel fuel by importers or producers (including registered wholesale distributors). Because of concerns that this system fostered considerable tax evasion, Congress made significant changes to the tax in the 1993 Act. Effective January 1, 1994, tax is imposed on diesel fuel when it is removed at the terminal rack, and diesel fuel may be removed tax free only if the fuel contains a prescribed type and amount of dye. These changes made the taxing point readily identifiable, required untaxed fuel to be physically identified (that is, dyed), and reduced the number of taxpayers.

Temporary regulations (TD 8496 [1993-2 C.B. 281]) relating to these changes (the diesel fuel regulations) were published in the Federal Register on November 30, 1993 (58 FR 63069), along with a notice of proposed rulemaking (PS-52-93 [1993-2 C.B. 639]) cross-referencing the temporary regulations (58 FR 63131). Amendments to these temporary regulations (TD 8512 [1994-1 C.B. 273]) relating to dye color and concentration were published in the Federal Register on December 27, 1993 (58 FR 68304), along with a notice of proposed rulemaking (PS-76-93 [1994-1 C.B.

832]) cross-referencing those amendments (58 FR 68338). Written comments responding to the proposed diesel fuel regulations were received and a public hearing was held on March 22, 1994. Final regulations (TD 8550 [1994-2 C.B. 243]) relating to dye color and concentration were published in the Federal Register on June 30, 1994 (59 FR 33656).

The conforming regulations. On October 19, 1994, the IRS published in the Federal Register (59 FR 52735) proposed regulations (PS-66-93 [1994-2 C.B. 907]) that generally consolidate the rules relating to the gasoline tax and the diesel fuel tax into a single set of rules applicable to both fuels (the conforming regulations). The conforming regulations also proposed rules relating to gasohol and compressed natural gas.

Written comments regarding the proposed conforming regulations were received and a public hearing was held on January 11, 1995.

Final regulations (TD 8609 [1995-37 I.R.B. 5]) relating to gasohol and compressed natural gas were published in the Federal Register on August 7, 1995 (60 FR 40079).

The final regulations. After consideration of written comments and comments made at the public hearings, the proposed diesel fuel regulations and the proposed conforming regulations are adopted as revised by this Treasury decision. Comments and revisions are discussed below.

Significant Issues Raised in Comments and Changes Made in the Final Regulations

Treatment of kerosene

The temporary diesel fuel regulations provide that kerosene would not be treated as diesel fuel before July 1, 1994, and invited comments on the treatment of kerosene after June 30, 1994. Notice 94-72 (1994-2 C.B. 553) informed taxpayers that the IRS was reviewing this issue and would not change the treatment of kerosene until the issuance of further guidance. The IRS is continuing its review of this issue. Accordingly, the final regulations do not treat kerosene as diesel fuel.

Because kerosene is not treated as diesel fuel, a person that adds kerosene

to diesel fuel outside of the bulk transfer/terminal system generally must pay tax on the added kerosene and must be registered by the IRS.

Removal from certain refineries

The temporary diesel fuel regulations provide that tax is not imposed on the removal of undyed diesel fuel from an approved refinery for delivery to an approved terminal if the fuel is removed by rail car, the refinery and the terminal are operated by the same taxable fuel registrant, and the refinery is not served by pipeline or vessel.

One commentator noted that one of its refineries is not serviced by pipeline, vessel, or rail. In response to this comment, the final regulations expand this rule so that diesel fuel also may be removed tax free from an approved refinery that is not served by pipeline, vessel, or rail if the removal is by a trailer or semi-trailer and additional prescribed conditions are met.

Notice relating to sales and removals of dyed diesel fuel

The temporary diesel fuel regulations provide that terminal operators and others who sell dyed diesel fuel are responsible for informing their customers that the dyed fuel cannot be used for a taxable purpose and that a penalty may be imposed for taxable use (the notice requirement). Any person that fails to comply with the notice requirement is, for purposes of the penalty for misuse of dyed fuel imposed by section 6714, presumed to know that the dyed diesel fuel will not be used for a nontaxable use.

Under the final regulations, only terminal operators and certain retail sellers will be subject to the notice requirement. A terminal operator must comply with the notice requirement as one of the terms and conditions of its registration.

Visual inspection devices

The temporary diesel fuel regulations do not require the use of visual inspection devices and the final regulations continue this policy. The IRS will continue to evaluate the need for regulations addressing this issue. However, the use of visual inspection devices is encouraged so that the buyers and sellers of diesel fuel may

readily determine whether the fuel may be used for a taxable use.

Back-up tax; trains

A tax is imposed on the delivery of dyed diesel fuel into the fuel supply tank of a diesel-powered train. Under the temporary diesel fuel regulations, the operator of the train into which dyed fuel is delivered is liable for the tax.

Several commentators noted that a prevalent practice in the railroad industry is for one railroad's locomotives to be used to pull freight on another's track and to be fueled by the railroad that owns the track. In these situations, the identity of the operator is unclear.

In response to these comments, the final regulations provide that the person that delivers dyed diesel fuel into the fuel supply tank of a train is liable for the tax under certain prescribed conditions.

Credits and payments

Information to be submitted with claims. If undyed diesel fuel is used in a nontaxable use, a credit or payment is allowable to either (1) the ultimate purchaser or (2) in the case of diesel fuel used on a farm for farming purposes or by a State or local government, the registered ultimate vendor of the fuel. The temporary diesel fuel regulations prescribe the information that must be submitted to the IRS to support claims for these credits or payments.

Several commentators asserted that the information requirements in the diesel fuel temporary regulations are too burdensome. In response to these comments, the final regulations reduce the paperwork requirements for claimants by eliminating certain items from the list of required submissions. However, the paperwork requirements may be changed in the future if the IRS determines that additional information is necessary for effective enforcement of the tax.

Notice 94-61. Notice 94-61 (1994-1 C.B. 371) announced that the temporary diesel fuel regulations would be revised to clarify that (1) a registered ultimate vendor is the only person allowed a credit or payment with respect to diesel fuel used on a farm for farming purposes or by State or local governments, and (2) a credit or

payment generally is allowed to a registered ultimate vendor who sells undyed diesel fuel to a custom harvester for use on a farm for farming purposes. The final regulations contain these revisions.

Undyed diesel fuel mixed with dyed diesel fuel. One condition for the allowance of a credit or payment under section 6427 is that tax must have been imposed on the diesel fuel to which the claim relates. Because untaxed diesel fuel is dyed, the temporary diesel fuel regulations require each claim to be accompanied by a statement that the diesel fuel covered by a claim did not contain visible evidence of dye.

On rare occasions, however, an amount of taxed diesel fuel may contain visible evidence of dye. This may occur, for example, when dyed diesel fuel and undyed diesel fuel are mixed together by a fuel marketer or user who accidentally delivers one type of fuel into a storage tank that already contains the other type of fuel.

The final regulations provide that each claim must be accompanied by a statement that tax has been imposed on the diesel fuel covered by a claim. Generally, this requirement will be met by a claimant's statement that the diesel fuel did not contain visible evidence of dye. However, for claims involving taxed fuel that has been mixed with dyed fuel, the claimant (that is, the ultimate purchaser or the registered ultimate vendor) cannot make such a statement. For these claims, the claimant must submit other evidence showing that the diesel fuel covered by the claim has been subject to tax. This evidence might include a statement from the person that produced the undyed/dyed fuel mixture explaining how the mixing occurred or a statement from the claimant (if the claimant did not produce the mixture) that explains when and from whom the claimant acquired the mixture. As with all claims, these claims are subject to review by the IRS before they are allowed.

Section 6714 penalty

Section 6714(a)(3) provides that if any person willfully alters, or attempts to alter, the strength or composition of any dye or marking done pursuant to section 4082 in any dyed fuel, then such person shall pay a penalty in addition to the tax (if any).

Notice 94-21 (1994-1 C.B. 339) describes three situations in which the section 6714(a)(3) penalty does not apply. The final regulations incorporate the substance of the Notice. In addition, the final regulations provide that the section 6714(a)(3) penalty does not apply if dyed diesel fuel is blended with undyed diesel fuel and the blending occurs as part of an exempt or partially exempt (that is, bus or train) use. Thus, for example, the section 6714(a)(3) penalty does not apply if dyed and undyed diesel fuel are blended together in the fuel supply tank of a nonhighway vehicle such as a bulldozer or farm tractor.

Dye injection systems and markers

The final regulations do not require the use of dye injection systems or markers. These topics will be addressed in a future notice of proposed rule-making.

Effect on other documents

The following publications are obsolete as of March 14, 1996:

- Rev. Rul. 72-213, 1972-1 C.B. 328.
- Rev. Proc. 73-21, 1973-2 C.B. 471.
- Notice 88-26, 1988-1 C.B. 495.
- Notice 89-17, 1989-1 C.B. 647.
- Notice 94-18, 1994-1 C.B. 338.
- Notice 94-21, 1994-1 C.B. 339.
- Notice 94-61, 1994-1 C.B. 371.
- Notice 94-72, 1994-2 C.B. 553.

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 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, the notices of proposed rulemaking preceding these regulations were submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Frank Boland, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, chapter 1 is amended as follows:

**PART 40—EXCISE TAX
PROCEDURAL REGULATIONS**

Paragraph 1. The authority citation for part 40 is amended by removing the entry for sections 40.6011(a)-1, 40.6011(a)-2, and 40.6011(a)-3T and adding entries in numerical order to read in part as follows:

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

Section 40.6011(a)-1 also issued under 26 U.S.C. 6011(a).

Section 40.6011(a)-2 also issued under 26 U.S.C. 6011(a). * * *

Par. 2. Section 40.6011(a)-1(b) is amended by:

1. Redesignating the text of paragraph (b) following the heading as paragraph (b)(1) and adding a heading for newly designated paragraph (b)(1).
2. Adding paragraph (b)(2).

The additions read as follows:

§40.6011(a)-1 Returns.

* * * * *

(b) * * * (1) *In general.* * * *

(2) *Certain persons liable for tax on taxable fuel.* Effective January 1, 1994, the district director may require a person to make a return of tax for a monthly or semimonthly period in the manner prescribed in paragraph (b)(1) of this section if the person—

- (i) Is a bonded registrant (as defined in §48.4101-1(b) of this chapter) at any time during the period;
- (ii) Has been registered under section 4101 for less than one year at the beginning of the period;
- (iii) Meets the acceptable risk test of §48.4101-1(f)(3) of this chapter by reason of §48.4101-1(f)(3)(i)(B) of this chapter at any time during the period;

(iv) Has failed to comply with the applicable provisions of §48.4101-1(h) of this chapter (relating to the terms and conditions of registration);

(v) Is liable for tax under §48.4082-4(a) of this chapter (relating to the back-up tax on diesel fuel) at any time during the period; or

(vi) Is liable for tax under section 4081 (relating to the tax on taxable fuel) at any time during the period and is not a taxable fuel registrant at that time.

* * * * *

§40.6011(a)-3T [Removed]

Par. 3. Section 40.6011(a)-3T is removed.

PART 42—[REMOVED]

Par. 4. Part 42 is removed.

**PART 48—MANUFACTURERS
AND RETAILERS EXCISE TAXES**

Par. 5. The authority citation for part 48 is amended by removing the entries for sections 48.4081-4, 48.4082-1 and 48.4082-2T, 48.4101-3T, 48.4101-4T, 48.6427-8T and 48.6427-9T, and adding entries in numerical order to read in part as follows:

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

Section 48.4081-4 also issued under 26 U.S.C. 4083(a)(2). * * *

Section 48.4082-1 also issued under 26 U.S.C. 4082.

Section 48.4082-2 also issued under 26 U.S.C. 4082.

Section 48.4101-1 also issued under 26 U.S.C. 4101(a).

Section 48.4101-2 also issued under 26 U.S.C. 4101(d). * * *

Section 48.6427-8 also issued under 26 U.S.C. 6427(n).

Section 48.6427-9 also issued under 26 U.S.C. 6427(n).

Par. 6. Section 48.0-1 is amended by removing from the fourth sentence the language “gasoline, diesel and aviation fuel,” and adding “taxable fuel, aviation fuel,” in its place.

§48.4041-0T [Removed]

Par. 7. Section 48.4041-0T is removed.

Par. 8. Section 48.4041-0 is added to read as follows:

§48.4041-0 Applicability of regulations relating to diesel fuel after December 31, 1993.

Sections 48.4041-3 through 48.4041-17 do not apply to sales or uses of diesel fuel after December 31, 1993. For rules relating to the diesel fuel tax imposed by section 4041 after that date, see §48.4082-4.

§§48.4041-1 and 48.4041-2 [Removed]

Par. 9. Sections 48.4041-1 and 48.4041-2 are removed.

§48.4041-2T [Removed]

Par. 10. Section 48.4041-2T is removed.

§48.4041-21 [Amended]

§§48.4041-15 through 48.4041-21 [Transferred]

Par. 11. Sections 48.4041-15 through 48.4041-21 are transferred from subpart G to subpart F.

Par. 12. In the first sentence of §48.4041-21(c)(1), the language “§48.4082-4T(c)(1) through (5)(A) or (c)(6) through (11)” is removed and “§48.4082-4(c)(1) through (c)(4)(i) or (c)(5) through (c)(10)” is added in its place.

Par. 13. The heading for subpart G is revised to read as follows:

Subpart G—Fuel Used on Inland Waterways

Par. 14. Section 48.4042-1 is amended as follows:

1. Paragraphs (b) and (e) are revised.
2. In the introductory text of paragraph (f)(1), the language “(26)” is removed and “(27)” is added in its place.
3. Paragraphs (g)(25) and (g)(26) are redesignated as paragraphs (g)(26) and (g)(27), respectively, and a new paragraph (g)(25) is added.

The revisions and additions read as follows:

§48.4042-1 Tax on fuel used in commercial waterway transportation.

* * * * *

(b) *Amount of tax.* For the amount of tax, see section 4042(b).

* * * * *

(e) *Liquid fuel.* For purposes of the tax imposed under this section, *liquid fuel* means any liquid fuel including gasoline, diesel fuel, special motor fuel, or Bunker C residual fuel oil.

* * * * *

(g) * * *

(25) Tennessee-Tombigbee Waterway: From its confluence with the Tennessee River to the Warrior River at Demopolis, Alabama.

* * * * *

Par. 15. The heading for subpart H is revised to read as follows:

Subpart H—Motor Vehicles, Tires, Tubes, Tread Rubber, and Taxable Fuel

Par. 16. Section 48.4064-1(e)(2) is amended by removing the language “Form 843” and adding “Form 8849 (or on such other form as the Commissioner may designate)” in its place.

Par. 17. The undesignated center heading preceding §48.4081-1 is revised to read as follows:

TAXABLE FUEL

Par. 18. Sections 48.4081-1, 48.4081-2 and 48.4081-3 are revised to read as follows:

§48.4081-1 Taxable fuel; definitions.

(a) *Overview.* This section provides definitions for purposes of the tax on taxable fuel imposed by section 4081.

(b) *Definitions.*

Approved terminal or refinery means a terminal or refinery that is operated, respectively, by a taxable fuel registrant that is a terminal operator, or by a taxable fuel registrant that is a refiner.

Blender means any person that produces blended taxable fuel.

Bulk transfer means any transfer of taxable fuel by pipeline or vessel.

Bulk transfer/terminal system means the taxable fuel distribution system consisting of refineries, pipelines, vessels, and terminals. Thus, taxable fuel in a refinery, pipeline, vessel, or terminal is in the bulk transfer/terminal

system. Taxable fuel in the fuel supply tank of any engine, or in any tank car, rail car, trailer, truck, or other equipment suitable for ground transportation is not in the bulk transfer/terminal system.

Bus means automobile bus.

Diesel-powered boat means any waterborne vessel of any size or configuration that is propelled, in whole or in part, by a diesel-powered engine.

Diesel-powered bus means any bus that is propelled by a diesel-powered engine.

Diesel-powered highway vehicle means a highway vehicle, as defined in §48.4041-8(b), that is propelled by a diesel-powered engine.

Diesel-powered train means any diesel-powered equipment or machinery that rides on rails. Thus, for example, the term includes a locomotive, work train, switching engine, and track maintenance machine.

Enterer generally means the importer of record (under customs law) with respect to the taxable fuel. However, if the importer of record is acting as an agent (for example, the importer of record is a customs broker engaged by the owner of the taxable fuel), the person for whom the agent is acting is the enterer. If there is no importer of record for taxable fuel entered into the United States, the owner of the taxable fuel at the time it is brought into the United States is the enterer.

Entry of taxable fuel into the United States occurs when—

(1) The taxable fuel is brought into the United States and applicable customs law requires that the taxable fuel be entered into the United States for consumption, use, or warehousing; or

(2) The taxable fuel is brought into the United States from Puerto Rico and applicable customs law would require that the taxable fuel be entered into the United States for consumption, use, or warehousing if the taxable fuel were brought into the United States from somewhere other than Puerto Rico.

Finished gasoline means all products (including gasohol (as defined in §48.4081-6(b)(2))) that are commonly or commercially known or sold as gasoline and are suitable for use as a motor fuel, other than products that have an ASTM octane number of less than 75 as determined by the motor method.

Gasoline means finished gasoline and gasoline blendstocks.

Industrial user means any person that receives gasoline blendstocks by bulk transfer for its own use in the manufacture of any product other than finished gasoline.

Position holder means, with respect to taxable fuel in a terminal, the person that holds the inventory position in the taxable fuel, as reflected on the records of the terminal operator. A person holds the inventory position in taxable fuel when that person has a contractual agreement with the terminal operator for the use of storage facilities and terminaling services at a terminal with respect to the taxable fuel. The term also includes a terminal operator that owns taxable fuel in its terminal.

Rack means a mechanism for delivering taxable fuel from a refinery or terminal into a truck, trailer, railroad car, or other means of nonbulk transfer.

Refiner means any person that owns, operates, or otherwise controls a refinery.

Refinery means a facility used to produce taxable fuel from crude oil, unfinished oils, natural gas liquids, or other hydrocarbons and from which taxable fuel may be removed by pipeline, by vessel, or at a rack. However, the term does not include a facility where only blended fuel or gasohol (as defined in §48.4081-6(b)(2)), and no other type of taxable fuel, is produced. For this purpose blended fuel is any mixture that, if produced outside the bulk transfer/terminal system, would be blended taxable fuel.

Removal means any physical transfer of taxable fuel, and any use of taxable fuel other than as a material in the production of taxable fuel or special fuels (as defined in §48.4041-8(f)). However, taxable fuel is not removed when it evaporates or is otherwise lost or destroyed.

Sale means—

(1) The transfer of title to, or substantial incidents of ownership in, taxable fuel (other than taxable fuel in a terminal) to the buyer for a consideration, which may consist of money, services, or other property; or

(2) The transfer of the inventory position in the taxable fuel in a terminal if the transferee becomes the position holder with respect to the taxable fuel.

State includes any State, any political subdivision of a State, the District of

Columbia, the American Red Cross, and, subject to the limitations of section 7871, any Indian tribal government.

Taxable fuel means gasoline and diesel fuel.

Taxable fuel registrant means an enterer, industrial user, refiner, terminal operator, or throughputter that is registered under section 4101.

Terminal means a taxable fuel storage and distribution facility that is supplied by pipeline or vessel, and from which taxable fuel may be removed at a rack. However, the term does not include any facility at which gasoline blendstocks are used in the manufacture of products other than finished gasoline and from which no gasoline is removed.

Terminal operator means any person that owns, operates, or otherwise controls a terminal.

Throughputter means any person that—

(1) Owns taxable fuel within the bulk transfer/terminal system (other than in a terminal); or

(2) Is a position holder.

Vessel means a waterborne taxable fuel transporting vessel.

(c) *Blended taxable fuel, diesel fuel, and gasoline blendstocks; definitions—*

(1) *Blended taxable fuel—*(i) *In general.* Except as provided in paragraphs (c)(1)(ii) and (c)(1)(iii) of this section, *blended taxable fuel* means any mixture that is produced outside the bulk transfer/terminal system and that consists of—

(A) Taxable fuel with respect to which tax has been imposed under section 4041(a)(1) or 4081(a); and

(B) Any other liquid on which tax has not been imposed under section 4081.

(ii) *Exclusion; minor blending.* A mixture described in paragraph (c)(1)(i) of this section is not blended taxable fuel if, during the calendar quarter in which the blender removes or sells the mixture, all such mixtures removed or sold by the blender contain, in the aggregate, less than 400 gallons of liquid described in paragraph (c)(1)(i)(B) of this section.

(iii) *Exclusion; gasohol.* Blended taxable fuel does not include any gasohol (as defined in §48.4081-6(b)(2)) if, disregarding the alcohol, the gasohol is not blended taxable fuel and contains, in addition to permitted

amounts of liquids described in paragraph (c)(1)(i)(B) of this section, only gasoline with respect to which—

(A) Tax was imposed under section 4081(a) at a rate described in §48.4081-6(e) (relating to the gasohol production tax rate and the gasohol tax rate); or

(B) A valid claim is made under section 6427(f).

(2) *Diesel fuel.* (i) Effective April 1, 1996, *diesel fuel* means any liquid (other than gasoline) that, without further processing or blending, is suitable for use as a fuel in a diesel-powered highway vehicle, diesel-powered train, or diesel-powered boat. However, *diesel fuel* does not include kerosene, No. 5 and No. 6 fuel oils (as described in ASTM Specification D 396, which may be obtained from the American Society for Testing and Materials, 100 Barr Harbor Drive, West Conshohocken, PA 19428), or F-76 (Fuel Naval Distillate MIL-F-16884, which may be obtained from Standardization Document Order Desk, Building 4, Section D, 700 Robbins Avenue, Philadelphia, PA 19111).

(ii) Before April 1, 1996, *diesel fuel* means any liquid (other than kerosene) that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle, diesel-powered train, or diesel-powered boat. A liquid meets this requirement if, without further processing or blending, the liquid has practical and commercial fitness for use in the propulsion engine of the highway vehicle, train, or boat. A liquid may possess this practical and commercial fitness even though the specified use is not the liquid's predominant use. However, a liquid does not possess this practical and commercial fitness solely by reason of its possible or rare use as a fuel in the propulsion engine of a highway vehicle, train, or boat.

(iii) *Cross reference.* For the tax on blended taxable fuel, see §48.4081-3(g). For the back-up tax on certain uses of liquids other than diesel fuel, see §48.4082-4.

(3) *Gasoline blendstocks—*(i) *In general.* Except as provided in paragraph (c)(3)(ii) of this section, *gasoline blendstocks* means—

(A) Alkylate;

(B) Butane;

(C) Butene;

(D) Catalytically cracked gasoline;

- (E) Coker gasoline;
- (F) Ethyl tertiary butyl ether (ETBE);
- (G) Hexane;
- (H) Hydrocrackate;
- (I) Isomerate;
- (J) Methyl tertiary butyl ether (MTBE);
- (K) Mixed xylene (not including any separated isomer of xylene);
- (L) Natural gasoline;
- (M) Pentane;
- (N) Pentane mixture;
- (O) Polymer gasoline;
- (P) Raffinate;
- (Q) Reformate;
- (R) Straight-run gasoline;
- (S) Straight-run naphtha;
- (T) Tertiary amyl methyl ether (TAME);
- (U) Tertiary butyl alcohol (gasoline grade) (TBA);
- (V) Thermally cracked gasoline;
- (W) Toluene; and
- (X) Transmix containing gasoline.

(ii) *Exclusion. Gasoline blendstocks* does not include any product that cannot, without further processing, be used in the production of finished gasoline. For example, a mixed hydrocarbon stream that is produced in a natural gas processing plant is not a gasoline blendstock if the stream cannot be used to produce finished gasoline without further processing.

(d) *Effective date.* This section is effective January 1, 1994.

§48.4081-2 Taxable fuel; tax on removal at a terminal rack.

(a) *Overview.* This section provides the general rule that all removals of taxable fuel at a terminal rack are subject to tax and the position holder with respect to the fuel is liable for the tax.

(b) *Imposition of tax.* Except as provided in §48.4081-4 (relating to gasoline blendstocks) and §48.4082-1 (relating to dyed diesel fuel), tax is imposed on the removal of taxable fuel from a terminal if the taxable fuel is removed at the rack.

(c) *Liability for tax—(1) In general.* The position holder with respect to the taxable fuel is liable for the tax imposed under paragraph (b) of this section.

(2) *Joint and several liability of terminal operator; unregistered position holder—(i) In general.* The terminal operator is jointly and severally liable for the tax imposed under paragraph (b) of this section if—

(A) The position holder with respect to the taxable fuel is a person other than the terminal operator and is not a taxable fuel registrant; and

(B) The terminal operator has not met the conditions of paragraph (c)(2)(ii) of this section.

(ii) *Conditions for avoidance of liability.* A terminal operator is not liable for tax under this paragraph (c)(2) if, at the time of the removal, the terminal operator—

(A) Is a taxable fuel registrant;

(B) Has an unexpired notification certificate (as described in §48.4081-5) from the position holder; and

(C) Has no reason to believe that any information in the notification certificate is false.

(3) *Joint and several liability of terminal operator; incorrect information provided.* The terminal operator is jointly and severally liable for the tax imposed under paragraph (b) of this section if, in connection with the removal of diesel fuel that is not dyed and marked in accordance with §48.4082-1, the terminal operator provides any person (including the position holder with respect to the fuel) with any bill of lading, shipping paper, record, or similar document indicating that the diesel fuel is dyed and marked in accordance with §48.4082-1.

(4) *Example.* The following example illustrates this paragraph (c) and §48.4082-1:

Example. (i) TO is a terminal operator and PH is the position holder with respect to, and owner of, 8,000 gallons of diesel fuel stored in TO's terminal. TO and PH are taxable fuel registrants. When the fuel is removed from the terminal at the rack, the fuel is not dyed and marked in accordance with §48.4082-1, and TO does not provide any person with any paperwork indicating that the fuel is dyed and marked. After the removal from the terminal, PH sells the fuel to individuals for use as heating oil, a nontaxable use.

(ii) Because PH is the position holder of the fuel at the time of the removal from the terminal, PH is liable for the tax imposed by section 4081. The removal is subject to tax because the fuel is not dyed and marked in accordance with §48.4082-1, and later use of the fuel in a nontaxable use does not make the removal from the terminal exempt from tax.

(iii) Because PH is a taxable fuel registrant and TO did not provide any person with any

paperwork indicating that the fuel is dyed and marked, TO is not jointly and severally liable for tax under paragraph (c)(2) or (3) of this section.

(d) *Rate of tax.* For the rate of tax generally, see section 4081(a). For the rate of tax on gasohol and on gasoline removed for gasohol production, see §48.4081-6.

(e) *Effective date.* This section is effective January 1, 1994.

§48.4081-3 Taxable fuel; taxable events other than removal at the terminal rack.

(a) *Overview.* Although tax is imposed when taxable fuel is removed from the terminal at the rack, tax also is imposed in certain other situations described in this section. For the back-up tax on the use of dyed diesel fuel, see §48.4082-4.

(b) *Tax on removal from a refinery—(1) Imposition of tax.* Except as provided in paragraph (b)(2) of this section (relating to an exemption for certain refineries), §48.4081-4 (relating to gasoline blendstocks), and §48.4082-1 (relating to dyed diesel fuel), tax is imposed on the following removals from a refinery:

(i) A removal by bulk transfer if the refiner or the owner of the taxable fuel immediately before the removal is not a taxable fuel registrant.

(ii) A removal at the rack.

(iii) After September 30, 1995, a removal of a batch of gasohol from an approved refinery by bulk transfer if the refiner treats itself with respect to the removal as a person that is not registered under section 4101. See §48.4101-1(a). For the rule providing that no deposit is required in the case of the tax imposed under this paragraph (b)(1)(iii), see §40.6302(c)-1(e)(4) of this chapter. For the rule allowing inspections of facilities where gasohol is produced, see section 4083.

(2) *Exception for certain refineries.* The tax imposed under paragraph (b)-(1)(ii) of this section does not apply to a removal of taxable fuel if—

(i) The taxable fuel is removed from an approved refinery that is not served by pipeline (other than a pipeline for the receipt of crude oil) or vessel;

(ii) The taxable fuel is received at a facility that is operated by a taxable fuel registrant and is located within the bulk transfer/terminal system;

(iii) The removal from the refinery is by—

(A) Rail car; or

(B) In the case of diesel fuel, a trailer or semi-trailer that is used exclusively for the transport service described in paragraphs (b)(2)(i) and (b)(2)(ii) of this section;

(iv) In the case of taxable fuel removed by rail car, the facility at which the fuel is received is operated by the same person that operates the refinery from which the fuel was removed; and

(v) In the case of diesel fuel removed by a trailer or semi-trailer, the facility at which the fuel is received is less than 20 miles from the refinery from which the diesel fuel was removed.

(3) *Liability for tax.* The refiner is liable for the tax imposed under paragraph (b)(1) of this section.

(c) *Tax on entry into the United States—(1) Imposition of tax.* Except as provided in §48.4081-4 (relating to gasoline blendstocks) and §48.4082-1 (relating to dyed diesel fuel), a tax is imposed on the entry of taxable fuel into the United States if—

(i) The entry is by bulk transfer and the enterer is not a taxable fuel registrant; or

(ii) The entry is not by bulk transfer.

(2) *Liability for tax.* The enterer is liable for the tax imposed under paragraph (c)(1) of this section.

(d) *Tax on bulk transfers from a terminal by an unregistered position holder—(1) Imposition of tax.* A tax is imposed on the removal by bulk transfer of taxable fuel from a terminal if the position holder with respect to the taxable fuel is not a taxable fuel registrant.

(2) *Liability for tax—(i) In general.* The position holder with respect to the taxable fuel is liable for the tax imposed under paragraph (d)(1) of this section.

(ii) *Joint and several liability of terminal operator.* The terminal operator is jointly and severally liable for the tax imposed under paragraph (d)(1) of this section if—

(A) The position holder with respect to the taxable fuel is a person other than the terminal operator; and

(B) The terminal operator has not met the conditions of paragraph (d)(2)(iii) of this section.

(iii) *Conditions for avoidance of liability.* A terminal operator is not liable for tax under this paragraph (d)(2) if, at

the time of the bulk transfer, the terminal operator—

(A) Is a taxable fuel registrant;

(B) Has an unexpired notification certificate (described in §48.4081-5) from the position holder; and

(C) Has no reason to believe that any information in the notification certificate is false.

(e) *Tax on bulk transfers not received at an approved terminal or refinery—(1) Imposition of tax.* Except as provided in §48.4081-4 (relating to gasoline blendstocks) and §48.4082-1 (relating to dyed diesel fuel), a tax on taxable fuel is imposed if—

(i) Taxable fuel is removed by bulk transfer from a refinery or terminal, or entered by bulk transfer into the United States;

(ii) No tax was imposed on such removal or entry under paragraph (b), (c), or (d) of this section; and

(iii) Upon removal from the pipeline or vessel, the taxable fuel is not received at an approved terminal or refinery (or at another pipeline or vessel).

(2) *Liability for tax—(i) In general.* The owner of the taxable fuel when it is removed from the pipeline or vessel is liable for the tax imposed under paragraph (e)(1) of this section if the owner has not met the conditions of paragraph (e)(2)(ii) of this section.

(ii) *Conditions for avoidance of liability.* An owner of taxable fuel is not liable for tax under paragraph (e)(2)(i) of this section if, at the time the taxable fuel is removed from the pipeline or vessel, the owner of the taxable fuel—

(A) Is a taxable fuel registrant;

(B) Has an unexpired notification certificate (described in §48.4081-5) from the operator of the terminal or refinery where the taxable fuel is received; and

(C) Has no reason to believe that any information in the notification certificate is false.

(iii) *Liability of the operator of the facility where the taxable fuel is received.* The operator of the facility where the taxable fuel is received is liable for the tax imposed under paragraph (e)(1) of this section if the owner of the taxable fuel has met the conditions of paragraph (e)(2)(ii) of this section and is jointly and severally liable for the tax if the owner has not met such conditions.

(f) *Tax on sales within the bulk transfer/terminal system—(1) Imposition of tax.* Except as provided in paragraph (f)(2) of this section and §48.4082-1 (relating to dyed diesel fuel), a tax is imposed on the sale of taxable fuel located within the bulk transfer/terminal system if the sale is to a person that is not a taxable fuel registrant and tax has not been imposed on such taxable fuel under §48.4081-2, or paragraph (b), (c), (d), or (e) of this section.

(2) *Exception for certain sales of taxable fuel for export.* The tax imposed under paragraph (f)(1) of this section does not apply to a sale of taxable fuel if—

(i) The buyer's principal place of business is not within the United States;

(ii) The sale of the fuel occurs as the fuel is delivered into a transport vessel;

(iii) The vessel has a capacity of at least 20,000 barrels of fuel;

(iv) The seller is a taxable fuel registrant and the exporter of record of the fuel; and

(v) The fuel was exported in due course.

(3) *Liability for tax—(i) In general.* The seller of the taxable fuel is liable for the tax imposed under paragraph (f)(1) of this section if the seller has not met the conditions of paragraph (f)(3)(ii) of this section.

(ii) *Conditions for avoidance of liability.* A seller is not liable for tax under paragraph (f)(3)(i) of this section if, at the time of the sale, the seller—

(A) Is a taxable fuel registrant;

(B) Has an unexpired notification certificate (described in §48.4081-5) from the buyer; and

(C) Has no reason to believe that any information in the certificate is false.

(iii) *Liability of the buyer.* The buyer of the taxable fuel is liable for the tax imposed under paragraph (f)(1) of this section if the seller of the taxable fuel has met the conditions of paragraph (f)(3)(ii) of this section and is jointly and severally liable for the tax if the seller has not met such conditions.

(4) *Example.* The following example illustrates this paragraph (f) and the definition of the term *sale* in §48.4081-1:

Example. PH owns one million gallons of untaxed gasoline that is stored in TO's terminal.

PH also is the position holder with respect to the gasoline. While the gasoline remains stored in the terminal, PH transfers title to 200,000 gallons of the gasoline to A, a person that is not a taxable fuel registrant. PH continues to hold the inventory position on TO's records with respect to the one million gallons. Because PH continues as the position holder with respect to the gasoline, the transfer of title to the gasoline from PH to A is not a sale of gasoline. Because this transfer of title from PH to A is not a sale of gasoline, the tax imposed under paragraph (f) of this section does not apply to the transfer.

(g) *Tax on removal or sale of blended taxable fuel by the blender—*

(1) *Imposition of tax.* A tax is imposed on the removal or sale of blended taxable fuel by the blender thereof. Tax is computed on the difference between the total number of gallons of blended taxable fuel removed or sold and the number of gallons of previously taxed taxable fuel used to produce the blended taxable fuel. For this purpose, the alcohol in gasohol is treated as previously taxed taxable fuel.

(2) *Liability for tax.* The blender is liable for the tax imposed under paragraph (g)(1) of this section.

(3) *Example.* The following example illustrates the provisions of this paragraph (g) and the definition of the term *blended taxable fuel* in §48.4081-1(c):

Example. (i) X, a gasoline wholesale distributor, buys 9,500 gallons of gasoline at a terminal rack. The gasoline is delivered into a tank trailer. The position holder is liable for tax under §48.4081-2 when the gasoline is removed at the rack. X then goes to another location where 500 gallons of alcohol (a substance not subject to tax under section 4081) are delivered into the tank trailer already containing the 9,500 gallons of gasoline. The gasoline and alcohol are splash blended as X drives to X's retail service station where X pumps the blended gasoline into a storage tank for sale to consumers.

(ii) X is a blender within the meaning of §48.4081-1 because X has produced blended taxable fuel, as defined in §48.4081-1, by mixing the 9,500 gallons of gasoline on which tax has been imposed under §48.4081-2(b) with 500 gallons of alcohol, a substance not subject to tax under section 4081. The 10,000 gallon mixture is not gasohol because it does not satisfy the alcohol-content requirement described in §48.4081-6(b)(2). X, the blender, is liable for the tax imposed under this paragraph (g) on the blended gasoline. The tax is imposed when the blended gasoline is removed from the tank trailer at the retail station. Tax on the blended mixture is computed on 500 gallons, the number of gallons not previously subject to tax under section 4081.

(h) *Rate of tax.* For the rate of tax generally imposed under this section, see section 4081(a). For the rate of tax on gasohol and on gasoline removed or entered for gasohol production, see §48.4081-6.

(i) *Effective date.* This section is effective January 1, 1994.

Par. 19. Section 48.4081-4 is amended as follows:

1. The heading for §48.4081-4 is revised.

2. In paragraph (a), the language "to produce gasoline" is removed and "to produce finished gasoline" is added in its place.

3. In paragraph (b)(1)(i), the language "gasoline registrant" is removed and "taxable fuel registrant" is added in its place.

4. In paragraph (b)(1)(ii), the language "gasoline (as defined in §48.4081-1(i)(1))" is removed and "finished gasoline" is added in its place.

5. In paragraphs (b)(2)(i) and (c)(1), the language "gasoline registrant" is removed each place it appears and "taxable fuel registrant" is added in its place.

6. The language "and" is added following the semicolon at the end of paragraph (c)(2).

7. Paragraph (c)(3) is revised.

8. Paragraph (c)(4) is removed.

9. In paragraph (d), the language "gasoline registrant" is removed and "taxable fuel registrant" is added in its place.

10. In paragraphs (e)(2) and (e)(3), the language "production of gasoline" is removed each place it appears and "production of finished gasoline" is added in its place.

11. In paragraph (e)(3), the language "to produce gasoline" is removed each place it appears, and "to produce finished gasoline" is added in its place.

12. In paragraph (f), the language "1993" is removed and "1994" is added in its place.

The revisions read as follows:

§48.4081-4 Gasoline; special rules for gasoline blendstocks.

* * * * *

(c) * * *

(3) Has no reason to believe that any information in the certificate is false.

* * * * *

Par. 20. Section 48.4081-5 is amended as follows:

1. The heading for §48.4081-5 is revised to read as follows:

§48.4081-5 Taxable fuel; notification certificate of taxable fuel registrant.

2. In paragraph (a), the first sentence in paragraph (b)(1) introductory text, and paragraph (b)(2), the language "gasoline" is removed each place it appears and "taxable fuel" is added in its place.

3. In paragraph (b)(3), the language "or letter of registration" is added after "Form 637" in the heading and after "(Form 637)" in the text.

4. In paragraph (c), the language "1993" is removed and "1994" is added in its place.

Par. 21. The heading for §48.4081-6 is revised to read as follows:

§48.4081-6 Gasoline; gasohol.

§40.4081-7 [Amended]

Par. 22. Section 48.4081-7 is amended as follows:

1. In paragraph (c)(2), two new listings are added at the end of the listings in line 5 of the taxpayer's report:

“_____ Removal at the terminal rack

_____ Removal or sale by the blender”

2. In paragraph (c)(4)(i)(A) and the first sentence of paragraph (c)(4)(iii), the language "§48.4081-1(r)" is removed and "§48.4081-1)" is added in its place.

Par. 23. Section 48.4081-8 is revised to read as follows:

§48.4081-8 Taxable fuel; measurement.

(a) *In general.* For purposes of the tax imposed by section 4081, gallons of taxable fuel may be measured on the basis of—

- (1) Actual volumetric gallons;
- (2) Gallons adjusted to 60 degrees Fahrenheit; or
- (3) Any other temperature adjustment method approved by the Commissioner.

(b) *Effective date.* This section is effective January 1, 1994.

§§48.4081-10T, 48.4081-11T, and 48.4081-12T [Removed]

Par. 24. Sections 48.4081-10T through 48.4081-12T are removed.

Par. 25. Section 48.4082-1 is revised to read as follows:

§48.4082-1 Diesel fuel tax; exemption.

(a) *Exemption.* Tax is not imposed by section 4081 on the removal, entry, or sale of any diesel fuel if—

(1) The person otherwise liable for tax is a taxable fuel registrant;

(2) In the case of a removal from a terminal, the terminal is an approved terminal; and

(3) The diesel fuel satisfies the dyeing and marking requirements of paragraphs (b), (c), and (d) of this section.

(b) *Dyeing requirements.* Diesel fuel satisfies the dyeing requirement of this paragraph (b) only if it contains—

(1) The dye Solvent Red 164 (and no other dye) at a concentration spectrally equivalent to at least 3.9 pounds of the solid dye standard Solvent Red 26 per thousand barrels of diesel fuel; or

(2) Any dye of a type and in a concentration that has been approved by the Commissioner.

(c) *Marking requirements.* [Reserved]

(d) *Time for adding the dye and marker.* [Reserved]

(e) *Effective date.* This section is effective March 14, 1966.

§§48.4082-2T, 48.4082-3T, 48.4082-4T and 48.4083 [Removed]

Par. 26. Sections 48.4082-2T, 48.4082-3T, 48.4082-4T, and 48.4083 are removed.

Par. 27. Sections 48.4082-2, 48.4082-3, 48.4082-4, and 48.4083-1 are added to read as follows:

§48.4082-2 Diesel fuel tax; notice required with respect to dyed diesel fuel.

(a) *In general.* A legible and conspicuous notice stating: **DYED DIESEL FUEL, NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE** must be posted by a seller on any retail

pump or other delivery facility where it sells dyed diesel fuel for use by its buyer. Any seller that fails to post the required notice on any retail pump or other delivery facility where it sells dyed diesel fuel is, for purposes of the penalty imposed by section 6714, presumed to know that the fuel will not be used for a nontaxable use.

(b) *Cross reference; terminal operators.* For the requirement that terminal operators provide a notice with respect to dyed diesel fuel, see §48.4101-1(h)(3) (relating to terms and conditions of registration for terminal operators).

(c) *Effective date.* This section is effective January 1, 1994.

§48.4082-3 Diesel fuel; visual inspection devices. [Reserved]

§48.4082-4 Diesel fuel; back-up tax.

(a) *Imposition of tax—(1) In general.* Tax is imposed by section 4041 on the delivery into the fuel supply tank of the propulsion engine of a diesel-powered highway vehicle (other than a diesel-powered bus) or diesel-powered boat of—

(i) Any diesel fuel on which tax has not been imposed by section 4081;

(ii) Any diesel fuel on which a credit or payment has been allowed under section 6427; or

(iii) Any liquid other than gasoline or diesel fuel.

(2) *Liability for tax—(i) In general.* The operator of the highway vehicle or boat into which the fuel is delivered is liable for the tax imposed under paragraph (a)(1) of this section.

(ii) *Joint and several liability of the seller.* The seller of the fuel is jointly and severally liable for the tax imposed under paragraph (a)(1) of this section if the seller knows or has reason to know that the fuel will not be used in a nontaxable use.

(3) *Rate of tax.* The rate of tax is the rate imposed on diesel fuel by section 4081(a).

(b) *Tax on diesel fuel; buses and trains—(1) In general.* Tax is imposed by section 4041 on the delivery into the fuel supply tank of the propulsion engine of a diesel-powered bus or a diesel-powered train of—

(i) Any diesel fuel on which tax has not been imposed by section 4081;

(ii) Any diesel fuel on which a credit or payment has been allowed under section 6427; or

(iii) Any liquid other than gasoline or diesel fuel.

(2) *Liability for tax—(i) In general.* Except as provided in paragraph (b)(2)-(ii) of this section, the operator of the bus or train into which the fuel is delivered is liable for the tax imposed under paragraph (b)(1) of this section.

(ii) *Special rule for certain train operators.* The person that delivers the fuel into the fuel supply tank of a train, rather than the train operator, is liable for the tax imposed under paragraph (b)(1) of this section if, at the time of the delivery—

(A) The deliverer of the fuel and the operator of the train are both registered as train operators under §48.4101-1; and

(B) A written agreement between the deliverer of the fuel and the operator requires the deliverer to pay the tax imposed under paragraph (b)(1) of this section.

(3) *Rate of tax—(i) Buses—(A) In general.* The rate of tax under paragraph (b)(1) of this section is the sum of the rates described in sections 4041(a)(1)(C)(iii)(I) and 4041(d)(1) (the bus rate) if the bus is used to furnish (for compensation) passenger land transportation available to the general public and either such transportation is scheduled and along regular routes or the seating capacity of the bus is at least 20 adults (not including the driver). A bus is available to the general public if the bus is available for hire to more than a limited number of persons, groups, or organizations.

(B) *Other uses.* The rate of tax under paragraph (b)(1) of this section is the rate of tax imposed on diesel fuel by section 4081(a) if the bus is used for a purpose other than that described in paragraph (b)(3)(i)(A) of this section.

(ii) *Trains.* The rate of tax under paragraph (b)(1) of this section is the rate prescribed in section 4041 for diesel fuel sold for use in a train (the train rate).

(4) *Cross reference.* For the registration requirement relating to certain bus and train operators, see §48.4101-1(c)(2).

(c) *Exemptions.* The taxes imposed under paragraphs (a) and (b) of this section do not apply to a delivery of any liquid for—

(1) Use on a farm for farming purposes as that term and related terms are defined in §48.6420-4(a) through (g);

(2) The exclusive use of a State;
(3) Use described in section 4041(h) (relating to use in a vehicle owned by an aircraft museum);

(4) Use in a boat employed in—
(i) The business of commercial fishing;

(ii) The business of transporting persons or property for compensation or hire; or

(iii) Any other trade or business, unless the boat is used in any activity of a type generally considered to constitute entertainment, amusement, or recreation (within the meaning of section 274(a)(1)(A) and the regulations under that section);

(5) Use in a bus while the bus is engaged in the transportation of students and employees of schools (as defined in the last sentence of section 4221(d)(7)(C));

(6) Use in a qualified local bus (as defined in section 6427(b)(2)(D)) while the bus is engaged in furnishing (for compensation) intracity passenger land transportation that is available to the general public and is scheduled and along regular routes;

(7) Use in a highway vehicle that—
(i) Is not registered (and is not required to be registered) for highway use under the laws of any State or foreign country; and

(ii) Is used in the operator's trade or business or in an activity of the operator described in section 212 (relating to the production of income);

(8) The exclusive use of a nonprofit educational organization, as defined in §48.4221-6(b);

(9) Use in a highway vehicle that is owned by the United States and is not used on the highway; or

(10) Use in any boat operated by the United States for the exclusive use of the United States or any vessel of war of any foreign nation, as described in §48.4221-4(b)(5).

(d) *Effective date.* This section is effective January 1, 1994.

§48.4083-1 Taxable fuel; administrative authority.

(a) *In general*—(1) *Authority to inspect.* Officers or employees of the IRS designated by the Commissioner, upon presenting appropriate credentials and a written notice to the owner, operator, or agent in charge, are authorized to

enter any place and to conduct inspections in accordance with paragraphs (a) through (c) of this section.

(2) *Reasonableness.* Inspections will be performed in a reasonable manner and at times that are reasonable under the circumstances, taking into consideration the normal business hours of the place to be entered.

(b) *Place of inspection*—(1) *In general.* Inspections may be at any place at which taxable fuel is (or may be) produced or stored or at any inspection site where evidence of activities described in section 6714(a) may be discovered. These places may include, but are not limited to—

- (i) Any terminal;
- (ii) Any fuel storage facility that is not a terminal;
- (iii) Any retail fuel facility; or
- (iv) Any designated inspection site.

(2) *Designated inspection sites.* A designated inspection site is any State highway inspection station, weigh station, agricultural inspection station, mobile station, or other location designated by the Commissioner to be used as a fuel inspection site. A designated inspection site will be identified as a fuel inspection site.

(c) *Scope of inspection*—(1) *Inspection.* Officers or employees may physically inspect, examine or otherwise search any tank, reservoir, or other container that can or may be used for the production, storage, or transportation of fuel, fuel dyes, or fuel markers. Inspection may also be made of any equipment used for, or in connection with, production, storage, or transportation of fuel, fuel dyes, or fuel markers. This includes any equipment used for the dyeing or marking of fuel. This also includes books and records, if any, that are maintained at the place of inspection and are kept to determine excise tax liability under section 4081.

(2) *Detainment.* Officers or employees may detain any vehicle, train, or boat for the purpose of inspecting its fuel tanks and storage tanks. Detainment will be either on the premises under inspection or at a designated inspection site. Detainment may continue for such reasonable period of time as is necessary to determine the amount and composition of the fuel.

(3) *Removal of samples.* Officers or employees may take and remove samples of fuel in such quantities as are

reasonably necessary to determine the composition of the fuel.

(d) *Refusal to submit to inspection*—(1) *Imposition of penalty.* Any person that refuses to allow an inspection will be fined \$1,000 for each refusal. This penalty is in addition to any other penalty or tax that may be imposed upon that person or any other person liable for tax under section 4081 or penalty under section 6714.

(2) *Assessment of penalty.* This penalty is an assessable penalty and is assessed in accordance with section 6671.

(e) *Effective date.* This section is effective January 1, 1994.

Par. 28. The undesignated center heading preceding §48.4101-1 is removed.

Par. 29. Section 48.4101-1 is revised to read as follows:

§48.4101-1 Registration.

(a) *In general.* (1) This section provides rules relating to registration under section 4101 for purposes of the federal excise tax on taxable fuel imposed by sections 4041(a)(1) and 4081 and the credit or payment allowed to registered ultimate vendors of diesel fuel under section 6427.

(2) A person is registered under section 4101 only if the district director has issued a registration letter to the person and the registration has not been revoked or suspended.

(3) A refiner that is registered under section 4101 may, with respect to the bulk removal of any batch of gasohol from its refinery, treat itself as a person that is not registered. See §48.4081-3-(b)(1)(iii).

(4) Each business unit that has, or is required to have, a separate employer identification number is treated as a separate person. Thus, two business units (for example, a parent corporation and a subsidiary corporation, or a proprietorship and a related partnership), each of which has a different employer identification number, are two persons.

(5) A registration in effect on December 31, 1993, with respect to the tax on gasoline or diesel fuel is subject to the district director's review, and to revocation or suspension, under the standards set forth in this section, but remains in effect until the earlier of—

(i) The effective date of a registration issued under paragraph (g)(3) of this section; or

(ii) The effective date of the revocation or suspension of the registration under paragraph (i) of this section.

(b) *Definitions*—(1) *Applicant*. An *applicant* is a person that has applied for registration under paragraph (e) of this section.

(2) *Bonded registrant*. A *bonded registrant* is a person that has given a bond to the district director under paragraph (j) of this section as a condition of registration.

(3) *Gasohol bonding amount*. The *gasohol bonding amount* is the product of—

(i) The rate of tax applicable to later separation, as described in §48.4081-6-*f*(1)(iii); and

(ii) The total number of gallons of gasoline expected to be bought at the gasohol production tax rate by the gasohol blender during a representative 6-month period (as determined by the district director).

(4) *Penalized for a wrongful act*. A person has been *penalized for a wrongful act* if the person has—

(i) Been assessed any penalty under chapter 68 of the Internal Revenue Code (or similar provision of the law of any State) for fraudulently failing to file any return or pay any tax, and the penalty has not been wholly abated, refunded, or credited;

(ii) Been assessed any penalty under chapter 68 of the Internal Revenue Code, such penalty has not been wholly abated, refunded, or credited, and the district director determines that the conduct resulting in the penalty is part of a consistent pattern of failing to deposit, pay, or pay over a substantial amount of tax;

(iii) Been convicted of a crime under chapter 75 of the Internal Revenue Code (or similar provision of the law of any State), or of conspiracy to commit such a crime, and the conviction has not been wholly reversed by a court of competent jurisdiction;

(iv) Been convicted, under the laws of the United States or any State, of a felony for which an element of the offense is theft, fraud, or the making of false statements, and the conviction has not been wholly reversed by a court of competent jurisdiction;

(v) Been assessed any tax under section 4103 and the tax has not been wholly abated, refunded, or credited; or

(vi) Had its registration under section 4101 or 4222 revoked.

(5) *Related person*. A *related person* is a person that—

(i) Directly or indirectly exercises control over an activity of the applicant if the activity is described in paragraph (c)(1) or (d) of this section;

(ii) Owns, directly or indirectly, five percent or more of the applicant;

(iii) Is under a duty to assure the payment of a tax for which the applicant is responsible;

(iv) Is a member, with the applicant, of a group of organizations (as defined in §1.52-1(b) of this chapter) that would be treated as a group of trades or businesses under common control for purposes of §1.52-1 of this chapter; or

(v) Distributed or transferred assets to the applicant in a transaction in which the applicant's basis in the assets is determined by reference to the basis of the assets in the hands of the distributor or transferor.

(6) *Registrant*. A *registrant* is a person that the district director has, in accordance with paragraph (g)(3) of this section, registered under section 4101 and whose registration has not been revoked or suspended.

(c) *Persons required to be registered*—(1) *In general*. A person is required to be registered under section 4101 if the person is a—

(i) Blender;

(ii) Enterer;

(iii) Refiner;

(iv) Terminal operator; or

(v) Position holder.

(2) *Bus and train operators*. Every operator of a bus or train is required to be registered under section 4101 at any time it incurs any liability for tax under section 4041 at the bus rate (as described in §48.4082-4(b)(3)(i)) or the train rate (as described in §48.4082-4(b)(3)(ii)).

(3) *Consequences of failing to register*. For the criminal penalty imposed for failure to register, see section 7232. For the civil penalty imposed for failure to register, see section 7272.

(d) *Persons that may, but are not required to, be registered*. A person may, but is not required to, be registered under section 4101 if the person is a—

(1) Gasohol blender;

(2) Industrial user;

(3) Throughputter that is not a position holder; or

(4) Ultimate vendor of diesel fuel.

(e) *Application instructions*. Application for registration under section 4101 must be made in accordance with the instructions for Form 637 (or such other form as the Commissioner may designate).

(f) *Registration tests*—(1) *In general*—(i) *Persons other than ultimate vendors*. Except as provided in paragraph (f)(1)(ii) of this section, the district director will register an applicant only if the district director determines that the applicant meets the following three tests (collectively, the registration tests):

(A) The activity test of paragraph (f)(2) of this section.

(B) The acceptable risk test of paragraph (f)(3) of this section.

(C) The adequate security test of paragraph (f)(4) of this section.

(ii) *Ultimate vendors*. The district director will register an applicant as an ultimate vendor of diesel fuel only if the district director—

(A) Determines that the applicant meets the activity test of paragraph (f)(2) of this section; and

(B) Is satisfied with the filing, deposit, payment, and claim history for all federal taxes of the applicant and any related person.

(2) *The activity test*. An applicant meets the activity test of this paragraph (f)(2) only if the district director determines that the applicant—

(i) Is, in the course of its trade or business, regularly engaged as an operator of a bus or train or in the characteristic activity of a person described in paragraph (c)(1) or (d) of this section; or

(ii) Is likely to be (because of such factors as the applicant's business experience, financial standing, or trade connections), in the course of its trade or business, regularly engaged as an operator of a bus or train or in the characteristic activity of a person described in paragraph (c)(1) or (d) of this section within a reasonable time after becoming registered under section 4101.

(3) *Acceptable risk test*—(i) *In general*. An applicant meets the acceptable risk test of this paragraph (f)(3) only if—

(A) Neither the applicant nor a related person has been penalized for a wrongful act; or

(B) Even though the applicant or a related person has been penalized for a

wrongful act, the district director determines, after review of evidence offered by the applicant, that the registration of the applicant does not create a significant risk of nonpayment or late payment of the tax imposed by sections 4041(a)(1) and 4081.

(ii) *Significant risk of nonpayment or late payment of tax.* In making the determination described in paragraph (f)(3)(i)(B) of this section, the district director may consider factors such as the following:

(A) The time elapsed since the applicant or related person was penalized for a wrongful act.

(B) The present relationship between the applicant and any related person that was penalized for any wrongful act.

(C) The degree of rehabilitation of the person penalized for any wrongful act.

(D) The amount of bond given by the applicant. In this regard, the district director may accept a bond under paragraph (j) of this section, without regard to the limits on the amount of the bond set by paragraph (j)(2) of this section.

(4) *Adequate security test*—(i) *In general.* An applicant meets the adequate security test of this paragraph (f)(4) only if the district director determines that the applicant has both adequate financial resources and a satisfactory tax history, or the applicant gives the district director a bond (under the provisions of paragraph (j) of this section).

(ii) *Adequate financial resources*—(A) *In general.* An applicant has adequate financial resources only if the district director determines that the applicant is financially capable of paying—

(1) Its expected tax liability under sections 4041(a)(1) and 4081 for a representative 6-month period (as determined by the district director);

(2) In the case of a terminal operator, the expected tax liability under section 4081 of persons other than the terminal operator with respect to taxable fuel removed at the racks of its terminals during a representative 1-month period (as determined by the district director); and

(3) In the case of a gasohol blender, the gasohol bonding amount.

(B) *Basis for determination.* The determination under this paragraph

(f)(4)(ii) must be based on financial information such as the applicant's income statement, balance sheet or bond ratings, or other information related to the applicant's financial status.

(iii) *Satisfactory tax history.* An applicant has a satisfactory tax history only if the district director is satisfied with the filing, deposit, and payment history for all federal taxes of the applicant and any related person.

(g) *Action on the application by the district director*—(1) *Review of application.* The district director may investigate the accuracy and completeness of any representations made by an applicant, request any additional relevant information from the applicant, and inspect the applicant's premises during normal business hours without advance notice.

(2) *Denial.* If the district director determines that an applicant does not meet all of the applicable registration tests described in paragraph (f) of this section, the district director must notify the applicant, in writing, that its application for registration is denied and state the basis for the denial.

(3) *Approval.* If the district director determines that an applicant meets all of the applicable registration tests described in paragraph (f) of this section, the district director must register the applicant under section 4101 and issue the applicant a letter of registration containing the effective date of the registration. The effective date of the registration must be no earlier than the date on which the district director signs the letter of registration. A copy of an application for registration (Form 637) is not a letter of registration.

(h) *Terms and conditions of registration*—(1) *Affirmative duties.* Each registrant must—

(i) Make deposits, file returns, and pay taxes required by the Internal Revenue Code and the regulations;

(ii) Keep records sufficient to show the registrant's tax liability under sections 4041(a)(1) and 4081 and payments or deposits of such liability;

(iii) Make all information reports required under section 4101(d) and §48.4101-2;

(iv) Make available for inspection on demand by the Internal Revenue Service during normal business hours records relevant to a determination of tax

liability under sections 4041(a)(1) and 4081; and

(v) Notify the district director of any change (such as a change in ownership) in the information the registrant submitted in connection with its application for registration, or previously submitted under this paragraph (h)(1)-(v), within 10 days after the change occurs.

(2) *Prohibited actions.* A registrant may not—

(i) Sell, lease or otherwise allow another person to use its registration;

(ii) Make any false statement to the district director in connection with a submission under paragraph (h)(1) or (h)(3) of this section;

(iii) Make any false statement on, or violate the terms of—

(A) A notification certificate of a taxable fuel registrant (as described in §48.4081-5(b)); or

(B) A certificate of a registered gasohol blender (as described in §48.4081-6(c)(2)).

(3) *Additional terms and conditions for terminal operators*—(i) *Notice required with respect to dyed diesel fuel.* A legible and conspicuous notice stating: **DYED DIESEL FUEL, NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE** must be provided by each terminal operator to any person that receives dyed diesel fuel at a terminal rack of that operator. This notice must be provided by the time of the removal and must appear on all shipping papers, bills of lading, and similar documents that are provided by the terminal operator to accompany the removal of the fuel.

(ii) *Records to be maintained relating to removals of diesel fuel.* Each terminal operator must keep the following information with respect to each rack removal of diesel fuel at each terminal it operates:

(A) The bill of lading or other shipping document.

(B) The record of whether the fuel was dyed and marked in accordance with §48.4082-1.

(C) The volume and date of the removal.

(D) The identity of the person, such as a common carrier, that physically received the fuel.

(E) Any other information required by the Commissioner.

(iii) *Records to be maintained relating to dye.* With respect to each of its

terminals, a terminal operator must keep records relating to dye inventories and usage.

(iv) *Retention of information.* In addition to any other requirement relating to the retention of records, the terminal operator must—

(A) Maintain the information described in paragraph (h)(3)(ii) of this section at the terminal from which the removal occurred for at least 3 months after the removal to which it relates; and

(B) Maintain the information described in paragraph (h)(3)(iii) of this section at the terminal where the dye was received for at least 3 months after the receipt.

(v) *Prohibition on providing incorrect information.* In connection with the removal of diesel fuel that is not dyed and marked in accordance with §48.4082-1, a terminal operator may not provide any person (including the position holder with respect to the fuel) with any bill of lading, shipping paper, or similar document indicating that the diesel fuel is dyed and marked in accordance with §48.4082-1.

(i) *Adverse actions by the district director against a registrant—(1) Mandatory revocation or suspension.* The district director must revoke or suspend the registration of any registrant if the district director determines that the registrant, at any time—

(i) Does not meet one or more of the applicable registration tests under paragraph (f) of this section and has not corrected the deficiency within a reasonable period of time after notification by the district director;

(ii) Has used its registration to evade, or attempt to evade, the payment of any tax imposed by section 4041(a)(1) or 4081, or to postpone or in any manner to interfere with the collection of any such tax, or to make a fraudulent claim for a credit or payment;

(iii) Has aided or abetted another person in evading, or attempting to evade, payment of any tax imposed by section 4041(a)(1) or 4081, or in making a fraudulent claim for a credit or payment; or

(iv) Has sold, leased, or otherwise allowed another person to use its registration.

(2) *Remedial action permitted in other cases.* If the district director determines that a registrant has, at any

time, failed to comply with the terms and conditions of registration under paragraph (h) of this section, made a false statement to the district director in connection with its application for registration or retention of registration, or otherwise used its registration in a manner that creates a significant risk of nonpayment or late payment of tax, then the district director may—

(i) Revoke or suspend the registrant's registration;

(ii) In the case of a registrant other than an ultimate vendor, require the registrant to give a bond under the provisions of paragraph (j) of this section as a condition of retaining its registration; and

(iii) In the case of a registrant other than an ultimate vendor, require the registrant to file monthly or semi-monthly returns under §40.6011(a)-1(b) of this chapter as a condition of retaining its registration.

(3) *Action by the district director to revoke or suspend a registration.* If the district director revokes or suspends a registration, the district director must so notify the registrant in writing and state the basis for the revocation or suspension. The effective date of the revocation or suspension may not be earlier than the date on which the district director notifies the registrant.

(j) *Bonds—(1) Form.* Each bond given to the district director as a condition of registration under paragraph (f)(4)(i) or (i)(2)(ii) of this section must be executed in the form prescribed by the district director. Each bond must be—

(i) A public debt obligation of the United States Government;

(ii) An obligation the principal and interest of which are unconditionally guaranteed by the United States Government;

(iii) A bond executed by a surety company listed in Department of the Treasury Circular 570 as an acceptable surety or reinsurer of federal bonds (a surety bond); or

(iv) Any other bond with security (including liens under section 4101(b)-(1)(B)) considered acceptable by the district director.

(2) *Amount of bond.* A bond given under this paragraph (j) must be in an amount that the district director determines will ensure timely collection of the taxes imposed by sections 4041(a)-(1) and 4081, taking into account the

applicant's financial capabilities, tax history, and expected liability under sections 4041(a)(1) and 4081. The district director may increase or decrease the amount of the required bond to take into account changes in the applicant's financial capabilities, tax history, and expected liability under sections 4041(a)(1) and 4081. However, in no case may the amount of the bond be greater than the amount that the district director determines is equal to—

(i) The applicant's expected tax liability under sections 4041(a)(1) and 4081 for a representative 6-month period (as determined by the district director);

(ii) In the case of a terminal operator, the expected tax liability of persons other than the terminal operator under section 4081 with respect to taxable fuel removed at the racks of its terminals (determined as if all removals of taxable fuel were taxable) during a representative 1-month period (as determined by the district director); and

(iii) In the case of a gasohol blender, the gasohol bonding amount.

(3) *Collection of taxes from a bond.* If a bonded registrant does not pay the amount of tax it incurs under section 4041(a)(1) or 4081 by the time prescribed in section 6151 for paying that tax, the district director may collect the amount of the unpaid tax (including penalties and interest with respect to that tax) from the bonded registrant's bond.

(4) *Termination of bonds—(i) Surety bonds.* A surety on a bond may give written notice to the district director and the bonded registrant that the surety desires to be relieved of liability under the bond after a certain date, which date must be at least 60 days after the receipt of the notice by the district director. The surety will be relieved of any liability that the bonded registrant incurs after the date named in the notice. However, the surety remains liable for the amount of tax that the bonded registrant incurred under sections 4041(a)(1) and 4081 during the term of the bond and for penalties and interest with respect to that tax.

(ii) *Other bonds.* A bond (other than a surety bond) given to the district director may be returned to the bonded registrant only after the earlier of—

(A) The district director's determination that the bonded registrant has paid all taxes that the bonded registrant

incurred under sections 4041(a)(1) and 4081 during the period covered by the bond and any penalties and interest with respect to the taxes;

(B) The expiration of the period for assessment of the taxes that the bonded registrant incurred under sections 4041(a)(1) and 4081 taxes during the period covered by the bond, as determined under the provisions of subchapter A of chapter 66 of the Internal Revenue Code; or

(C) The date that the district director receives from the registrant a substitute bond given under this paragraph (j).

(5) *Determination that bond is no longer required.* If the district director determines that the bonded registrant meets the adequate security test of paragraph (f)(4) of this section without a bond, the registrant is to be released from the obligation to give a bond as a condition of registration under section 4101.

(k) *Cross references.* For a rule relating to the filing of monthly and semimonthly returns by certain persons that are registered under section 4101, see §40.6011(a)–1(b)(2) of this chapter. For rules relating to the tax on taxable fuel, see §§48.4081–1 through 48.4083–1. For rules relating to claims by registered ultimate vendors, see §48.6427–9.

(l) *Effective dates.* (1) Except as otherwise provided in this paragraph (l), this section is applicable as of January 1, 1994.

(2) Paragraph (c)(1) of this section (relating to persons required to be registered) is applicable as of January 1, 1995.

(3) Paragraph (h)(3)(iii) of this section (relating to certain recordkeeping requirements) is applicable as of July 1, 1996.

Par. 30. Section 48.4101–2 is added to read as follows:

§48.4101–2 Information reporting.

(a) *In general*—(1) *Taxable fuel registrants.* Each taxable fuel registrant must make a return showing—

(i) The name and registration number (if any) of each person that is a position holder at each terminal it operates;

(ii) The amount of taxable fuel received at each terminal it operates;

(iii) The identity of each position holder with respect to—

(A) All rack removals of taxable fuel from each terminal it operates, and the volume and dates of the removals; and

(B) In the case of rack removals of diesel fuel, whether the fuel was dyed and marked at the operator’s terminal in accordance with §48.4082–1;

(iv) The amount of taxable fuel stored at each terminal it operates;

(v) The destination (by state) of all taxable fuel removed at a terminal rack of each terminal it operates, to the extent such information has been provided to the registrant;

(vi) The name and registration number (if any) of the operator of each terminal at which it is a position holder;

(vii) The volume and date of the removal with respect to all rack removals of taxable fuel for which it is the position holder;

(viii) In the case of nonbulk removals and entries of gasoline blendstocks for which it would be liable for tax but for the special rule in §48.4081–4(c), the name and registration number of each operator of each refinery and terminal where the gasoline blendstocks are received;

(ix) The name and registration number (if any) of each person to which it sells (within the meaning of §48.4081–1) taxable fuel located in the bulk transfer/terminal system;

(x) The name and registration number of each person from which it receives a certificate described in §48.4081–6(c) (relating to certificate of registered gasohol blender);

(xi) With respect to any liability incurred under §48.4081–3(e) (relating to tax on bulk transfers not received at an approved terminal or refinery)—

(A) The date on which the removal of the taxable fuel from a pipeline or vessel gave rise to the liability; and

(B) The location of the taxable fuel at the time of the removal; and

(xii) Any other information required by the Commissioner.

(2) *Gasohol blenders.* Each registered gasohol blender must make a return showing, with respect to each batch of gasohol it produced from gasoline it bought at the gasohol production tax rate—

(i) The name and registration number of the person that sold it the gasoline;

(ii) The date and location of the purchase of the gasoline;

(iii) The volume of the gasoline;

(iv) The name, address, and employer identification number of the person that sold it the alcohol;

(v) The date and location of the purchase of the alcohol;

(vi) The volume and type of the alcohol; and

(vii) Any other information required by the Commissioner.

(3) *Pipeline and vessel operators.* Each operator of a pipeline or vessel that makes a bulk transfer of taxable fuel to a terminal or refinery must make a return showing—

(i) The location of the terminal or refinery where the taxable fuel was delivered;

(ii) The date of the delivery; and

(iii) Any other information required by the Commissioner.

(b) *Form and time of return.* Each return required under this section must be made at the time and in the form required by the Commissioner.

(c) *Consequences for failure to make a return.* For the consequences for failing to make an information return required by this section, see §48.4101–1(i) (relating to adverse actions against a registrant) and section 6721 (relating to a penalty for failure to file an information return).

(d) *Effective date.* This section is applicable as of April 1, 1996.

§§48.4101–2T, 48.4101–3, 48.4101–3T, and 48.4101–4T [Removed]

Par. 31. Sections 48.4101–2T, 48.4101–3, 48.4101–3T, and 48.4101–4T are removed.

Par. 32. Section 48.4102–1 is amended as follows:

1. Paragraph (a) is revised.

2. Paragraph (b)(1) is amended by removing the language “on the sale or use of gasoline or lubricating oil, respectively,”.

3. Paragraph (b)(2) is amended by removing “gasoline or lubricating oil” each place it appears and adding “taxable fuel or aviation fuel” in its place.

The revision reads as follows:

§48.4102–1 Inspection of records by State or local tax officers.

(a) *Inspection of records maintained by taxpayer.* The records that a tax-

payer is required to keep with respect to the taxes imposed by section 4081 or 4091 must be open to inspection by any officer of any State or political subdivision thereof, or of the District of Columbia, who is charged with the enforcement or collection of any tax on taxable fuel or aviation fuel.

* * * * *

§48.4221 [Removed]

Par. 33. Section 48.4221 is removed.

Par. 34. Section 48.4221-1 is amended as follows:

1. Paragraph (a) is revised.
2. Paragraph (b)(2)(iv) is amended by adding "and" at the end.
3. Paragraph (b)(2)(v) is revised.
4. Paragraphs (b)(2)(vi) through (b)(2)(xiii) are removed.
5. Paragraph (b)(3) is removed and paragraphs (b)(4) and (b)(5) are redesignated as paragraphs (b)(3) and (b)(4), respectively.

The revised provisions read as follows:

§48.4221-1 Tax-free sales; general rule.

(a) *Application of regulations under section 4221—(1) In general.* The regulations under section 4221 provide rules under which the manufacturer, producer, or importer of an article subject to tax under chapter 32 (or the retailer of an article subject to tax under subchapter A or C of chapter 31) may sell the article tax free under section 4221.

(2) *Limitations.* The following restrictions must be taken into account in applying the regulations under section 4221:

(i) The exemptions under section 4221(a)(4) and (a)(5) do not apply to the tax imposed by section 4064 (gas guzzler tax).

(ii) The exemptions under section 4221 do not apply to the tax imposed by section 4081 (gasoline and diesel fuel tax).

(iii) The exemptions under section 4221 do not apply to the tax imposed by section 4091 (aviation fuel tax). For rules relating to tax-free sales of aviation fuel, see section 4092 and the regulations thereunder.

(iv) The exemptions under section 4221 do not apply to the tax imposed by section 4121 (coal tax).

(v) The exemptions under section 4221(a)(3) through (a)(5) do not apply to the tax imposed by section 4131 (vaccine tax). In addition, the exemption under section 4221(a)(2) applies to the vaccine tax only to the extent provided in §48.4221-3(e) (relating to tax-free sales of vaccine for export).

(vi) The exemptions under section 4221(a) apply only in those cases where the exportation or use referred to is to occur before any other use.

(b) * * *

(2) * * *

(v) Section 4221(e)(3) relating to the sale of tires used on intercity, local, or school buses (see §48.4221-8).

* * * * *

Par. 35. Section 48.4221-2 is amended by:

1. Removing from the first sentence of paragraph (a)(1) the language "(other than a tire or inner tube taxable under section 4071, which are given special treatment under sections 4221(e)(2) and (4), and §§48.4221-7 and 48.4221-8)" and adding "(other than a tire taxable under section 4071, which is given special treatment under section 4221(e)(2) and §48.4221-7)" in its place.

2. Removing paragraph (a)(2) and redesignating paragraph (a)(3) as paragraph (a)(2).

3. Revising paragraph (b).

The revision reads as follows:

§48.4221-2 Tax-free sale of articles to be used for, or resold for, further manufacture.

* * * * *

(b) *Circumstances under which an article is considered to have been sold for use in further manufacture.* (1) An article shall be treated as sold for use in further manufacture if the article is sold for use by the buyer as material in the manufacture or production of, or as a component part of, another article taxable under chapter 32 of the Internal Revenue Code.

(2) An article is used as material in the manufacture or production of, or as a component of, another article if it is incorporated in, or is a part or accessory of, the other article when the other article is sold by the manufacturer. In addition, an article is considered to be used as material in the manufacture of another article if it is

consumed in whole or in part in testing such other article. However, an article that is consumed in the manufacturing process other than in testing, so that it is not a physical part of the manufactured article, is not considered to have been used as material in the manufacture of, or as a component part of, another article.

* * * * *

Par. 36. Section 48.4221-5 is amended as follows:

1. Paragraph (c)(1) is amended by:
a. Removing the first sentence.

b. Removing the language "If a State or local government is not registered, the" and adding "The" in its place in the new first sentence.

2. In paragraph (d), the first sentence is amended by:

a. Removing the language "(whether on the basis of a registration number or an exemption certificate)".

b. Removing the language "(such as gasoline that is)" and adding "(such as tires that are)" in its place.

§§48.4221-8, 48.4221-9, 48.4221-10 [Removed]

Par. 37. Sections 48.4221-8, 48.4221-9, and 48.4221-10 are removed.

§48.4221-11 [Redesignated as §48.4221-8]

Par. 38. Section 48.4221-11 is redesignated as §48.4221-8.

§48.4221-12 [Removed]

Par. 39. Section 48.4221-12 is removed.

Par. 40. In §48.4222(a)-1, paragraphs (a) and (b) are revised to read as follows:

§48.4222(a)-1 Registration.

(a) *General rule.* Except as provided in §48.4222(b)-1, tax-free sales under section 4221 may be made only if the manufacturer, first purchaser, and second purchaser, as the case may be, have been registered by the Internal Revenue Service.

(b) *Application instructions.* Application for registration under section 4222 must be made in accordance with

instructions for Form 637 (or such other form as the Commissioner may designate).

* * * * *

Par. 41. In §48.4222(b)-1, paragraph (a) is revised to read as follows:

§48.4222(b)-1 Exceptions to the requirement for registration.

(a) *State and local governments.* The Internal Revenue Service will not register State or local governments under section 4222. To establish the right to sell articles tax free to a State or local government, the manufacturer must obtain the information described in §48.4221-5(c).

* * * * *

§48.4222(d)-1 [Amended]

Par. 42. Section 48.4222(d)-1 is amended by:

1. Removing paragraphs (a), (b), and (c).
2. Redesignating paragraph (d) as paragraph (a).
3. Removing paragraphs (e) and (f).
4. Redesignating paragraph (g) as paragraph (b).

§48.6206-1 [Removed]

Par. 43. Section 48.6206-1 is removed.

§48.6416(b)(2)-2 [Amended]

Par. 44. In §48.6416(b)(2)-2, paragraphs (g) through (k) are removed.

§48.6416(g)-1 [Removed]

Par. 45. Section 48.6416(g)-1 is removed.

§48.6421-3 [Amended]

Par. 46. In §48.6421-3, paragraph (d)(2) is amended by removing from the first sentence the language “Form 843” and adding “Form 8849 (or on such other form as the Commissioner may designate)” in its place.

§§6424-0 through 48.6424-6 [Removed]

Par. 47. Sections 48.6424-0 through 48.6424-6 are removed.

§48.6427-3 [Amended]

Par. 48. In §48.6427-3, paragraph (d)(2) is amended by removing from the first sentence the language “Form 843” and adding “Form 8849 (or on such other form as the Commissioner may designate)” in its place.

§48.6427-7 [Amended]

Par. 49. In §48.6427-7, paragraph (g)(4) is amended by removing the language “Form 843 (Claim)” and adding “Form 8849 (or such other form as the Commissioner may designate)” in its place.

Par. 50. Sections 48.6427-8 and 48.6427-9 are added to read as follows:

§48.6427-8 Claims by ultimate purchasers with respect to diesel fuel taxed after December 31, 1993.

(a) *Overview.* This section provides the rules for obtaining a credit or payment with respect to undyed diesel fuel that was taxed after December 31, 1993, and that was used in a nontaxable use (other than on a farm for farming purposes or by a State). A credit or payment for undyed diesel fuel used on a farm for farming purposes or by a State is allowable only to a registered ultimate vendor under the rules of §48.6427-9.

(b) *Conditions to allowance of credit or payment—(1) In general.* Except as provided in section 6427(l)(5), a claim for credit or payment with respect to diesel fuel is allowable under section 6427(l) only if—

- (i) Tax was imposed by section 4081 on the diesel fuel to which the claim relates;
- (ii) The claimant produced or bought the fuel and did not resell it in the United States;
- (iii) The claimant has filed a timely claim for a credit or payment that contains the information required under paragraph (d) of this section;
- (iv) The fuel was not bought under a certificate described in §48.6427-9(e)-(2) (relating to certificate of farmer or State to support claim of ultimate vendor);
- (v) The fuel was not used on a farm for farming purposes (as defined in §48.6420-4) or by a State; and
- (vi) The fuel was either—

(A) Used in a use described in §48.4082-4(c)(3) through (c)(10);

(B) Exported;

(C) Used other than as a fuel in a propulsion engine of a diesel-powered highway vehicle or diesel-powered boat;

(D) Used as a fuel in a propulsion engine of a diesel-powered train; or

(E) Used as a fuel in the propulsion engine of a diesel-powered bus if the bus was used in a use described in section 6427(b)(1) (after the application of section 6427(b)(3)).

(2) *Examples.* The following examples illustrate this paragraph (b).

Example 1. (i) In September 1996, F bought 250 gallons of undyed diesel fuel. In October 1996, F used 200 gallons of the fuel in a farm tractor. This use qualifies as use on a farm for farming purposes (as defined in §48.6420-4). The farm tractor is not a diesel-powered highway vehicle (as defined in §48.4081-1(h)). F used the remaining 50 gallons to heat F’s residence. F filed a complete and timely claim for a credit relating to the 250 gallons.

(ii) A credit or payment is not allowable to F with respect to the 200 gallons of diesel fuel used in the farm tractor. Even though this fuel was used other than as a fuel in a propulsion engine of a diesel-powered highway vehicle (thus meeting the condition in paragraph (b)(1)(vi)(C) of this section), the condition in paragraph (b)(1)(v) of this section is not satisfied because the fuel was used on a farm for farming purposes.

(iii) A credit is allowable to F with respect to the 50 gallons F used for heating purposes because the conditions in paragraph (b)(1) of this section have been met. F used this fuel other than as a fuel in a propulsion engine of a diesel-powered highway vehicle and the use of the fuel for residential heating is not use on a farm for farming purposes.

Example 2. (i) In September 1996, W, a wholesale distributor, sold 3,500 gallons of diesel fuel on which tax has been imposed to C, a construction company located in the United States. W’s selling price to C did not include an amount equal to the federal excise tax on the fuel. C used the fuel other than as a fuel in a propulsion engine of a diesel-powered highway vehicle or diesel-powered boat. Both W and C file a complete and timely claim for a credit relating to the fuel.

(ii) Because W resold the fuel in the United States, the condition of paragraph (b)(1)(ii) of this section is not met. Thus, W is not allowed a credit or payment with respect to the fuel.

(iii) C is eligible for a credit or payment with respect to the fuel because the conditions to allowance in paragraph (b)(1) of this section have been met. The conditions to allowance do not include a requirement that C buy the fuel at a price that includes the amount of the tax.

(c) *Form of claim.* Each claim for an income tax credit under this section must be made on Form 4136 (or on such other form as the Commissioner

may designate) in accordance with the instructions for that form. Each claim for a payment under this section must be made on Form 8849 (or on such other form as the Commissioner may designate) in accordance with the instructions for that form.

(d) *Content of claim.* Each claim for a credit or payment under this section must contain the following information with respect to all the diesel fuel covered by the claim:

(1) The total number of gallons covered by the claim.

(2) A statement by the claimant that tax has been imposed on the diesel fuel covered by the claim.

(3) The use made of the diesel fuel covered by the claim described by reference to specific categories listed in paragraph (b)(1)(vi) of this section (such as use in a boat employed in commercial fishing or the exclusive use of a nonprofit educational organization).

(4) If the diesel fuel covered by the claim was exported, a declaration that the claimant has proof of exportation (as described in §48.4221-3(d)(1)).

(5) A declaration that the claimant has in its possession the name and address of the person(s) that sold the diesel fuel to the claimant and the date(s) of the purchase(s).

(e) *Time and place for filing claim.* For rules relating to the time for filing a claim under section 6427, see section 6427(i). A claim under this section is not filed unless it contains all the information required by paragraph (d) of this section and is filed at the place required by the form.

(f) *Effective date.* This section is effective January 1, 1994, except for paragraph (b)(1)(v) of this section, which is effective for diesel fuel bought by ultimate purchasers after June 30, 1994.

§48.6427-9 Claims by registered ultimate vendors with respect to diesel fuel taxed after December 31, 1993.

(a) *Overview.* This section provides the rules for obtaining a credit or payment with respect to undyed diesel fuel that was taxed after December 31, 1993, and that was used on a farm for farming purposes or by a State.

(b) *Definitions.* (1) An *ultimate vendor*, as used in this section, is a

person that sells undyed diesel fuel to—

(i) The owner, tenant, or operator of a farm for use by such person on a farm for farming purposes (as defined in §48.6420-4);

(ii) A person other than the owner, tenant, or operator of a farm for use by such person for any of the purposes described in §48.6420-4(d) (relating to cultivating, raising, or harvesting); or

(iii) Any State for its exclusive use.

(2) A *registered ultimate vendor* is—

(i) An ultimate vendor that is registered under section 4101 as an ultimate vendor; or

(ii) With respect to a claim filed before January 1, 1995, an ultimate vendor that is registered as a producer of diesel fuel on December 31, 1993, if the registration has not been revoked or suspended.

(c) *Conditions to allowance of credit or payment.* A claim for a credit or payment with respect to diesel fuel is allowable under section 6427(l)(5) only if—

(1) Tax was imposed by section 4081 on the diesel fuel to which the claim relates;

(2) The claimant sold the diesel fuel to—

(i) The owner, tenant, or operator of a farm for use by such person on a farm for farming purposes (as defined in §48.6420-4);

(ii) A person other than the owner, tenant, or operator of a farm for use by such person for any of the purposes described in §48.6420-4(d) (relating to cultivating, raising, or harvesting); or

(iii) Any State for its exclusive use;

(3) The claimant is a registered ultimate vendor; and

(4) The claimant has filed a timely claim for a credit or payment that contains the information required under paragraph (e) of this section.

(d) *Form of claim.* Each claim for an income tax credit under this section must be made on Form 4136 (or on such other form as the Commissioner may designate) in accordance with the instructions for that form. Each claim for a payment under this section must be made on Form 8849 (or on such other form as the Commissioner may designate) in accordance with the instructions for that form.

(e) *Content of claim—(1) In general.* Each claim for credit or payment under

this section must contain the following information with respect to all the diesel fuel covered by the claim:

(i) The total number of gallons covered by the claim.

(ii) A statement by the claimant that tax has been imposed on the diesel fuel covered by the claim.

(iii) The claimant's registration number.

(iv) The name and taxpayer identification number of each person that bought diesel fuel from the claimant in a transaction described in paragraph (c)(2) of this section and the number of gallons that the claimant sold to that person.

(v) A statement that the claimant—

(A) Has not included the amount of the tax in its sales price of the diesel fuel and has not collected the amount of tax from its buyer;

(B) Has repaid the amount of the tax to the ultimate purchaser of the fuel; or

(C) Has obtained the written consent of its buyer to the allowance of the claim.

(vi) For claims relating to sales by the claimant after March 31, 1994, a statement that the claimant has in its possession an unexpired certificate described in paragraph (e)(2) of this section and the claimant has no reason to believe any information in the certificate is false.

(vii) For claims relating to sales by the claimant before April 1, 1994, either the statement described in paragraph (e)(1)(vi) of this section or a statement that—

(A) The claimant has in its possession an unexpired exemption certificate relating to tax-free sales of diesel fuel for use on a farm for farming purposes or for the exclusive use of a State;

(B) The certificate was received from the buyer before January 1, 1994; and

(C) The claimant has no reason to believe any information in the certificate is false.

(2) *Certificate—(i) In general.* The certificate to be provided to the ultimate vendor consists of a statement that is signed under penalties of perjury by a person with authority to bind the buyer, is in substantially the same form as the model certificate provided in paragraph (e)(2)(ii) of this section, and contains all information necessary to complete such model certificate. A new certificate must be given if any infor-

mation in the current certificate changes. The certificate may be included as part of any business records normally used to document a sale. The

certificate expires on the earlier of the following dates:

(A) The date one year after the effective date of the certificate.

(B) The date a new certificate is provided to the seller.

(ii) *Model certificate.*

CERTIFICATE OF FARMING USE OR STATE USE

(To support vendor's claim for a credit or payment under section 6427 of the Internal Revenue Code.)

Name, address, and employer identification number of vendor

The undersigned buyer ("Buyer") hereby certifies the following under penalties of perjury:

Buyer will use the diesel fuel to which this certificate relates—(check one)

_____ On a farm for farming purposes (as defined in §48.6420-4(c) of the Manufacturers and Retailers Excise Tax Regulations) and Buyer is the owner, tenant, or operator of the farm on which the fuel will be used;

_____ On a farm (as defined in §48.6420-4(c)) for any of the purposes described in paragraph (d) of that section (relating to cultivating, raising, or harvesting) and Buyer is a person that is not the owner, tenant, or operator of the farm on which the fuel will be used; or

_____ For the exclusive use of a State or local government, or the District of Columbia.

This certificate applies to the following (complete as applicable):

If this is a single purchase certificate, check here _____ and enter:

- 1. Invoice or delivery ticket number _____
2. _____ (number of gallons)

If this is a certificate covering all purchases under a specified account or order number, check here _____ and enter:

- 1. Effective date _____
2. Expiration date _____ (period not to exceed 1 year after the effective date)
3. Buyer account or order number _____

Buyer will provide a new certificate to the vendor if any information in this certificate changes.

If Buyer uses the diesel fuel to which this certificate relates for a purpose other than stated in the certificate Buyer will be liable for tax.

Buyer understands that the fraudulent use of this certificate may subject Buyer and all parties making such fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

Printed or typed name of person signing

Title of person signing

Name of Buyer

Employer identification number

Address of Buyer

Signature and date signed

(f) *Time and place for filing claim.* For rules relating to the time for filing a claim under section 6427, see section 6427(i). A claim under this section is not filed unless it contains all the information required by paragraph (e) of this section and is filed at the place required by the form.

(g) *Effective date.* This section is effective January 1, 1994.

§§48.6427-8T and 48.6427-9T [Removed]

Par. 51. Sections 48.6427-8T and 48.6427-9T are removed.

§48.6675-1 [Removed]

Par. 52. Section 48.6675-1 is removed.

Par. 53. Section 48.6714-1 is added to read as follows:

§48.6714-1 Penalty for misuse of dyed diesel fuel.

(a) *In general.* If any person willfully alters, or attempts to alter, the strength or composition of any dye or marking done pursuant to §48.4082-1 in any dyed fuel, then section 6714(a)-(3) provides that such person shall pay a penalty in addition to any tax. The penalty imposed by section 6714(a)(3) will not apply in the following cases:

(1) Diesel fuel that satisfies the dyeing and marking requirements of §48.4082-1(b) and (c) is blended with any undyed liquid and the resulting product satisfies the dyeing and marking requirements of §48.4082-1(b) and (c).

(2) Diesel fuel that satisfies the dyeing and marking requirements of §48.4082-1(b) and (c) is blended with any other liquid (other than diesel fuel) that contains the type and amount of dye and marker required for diesel fuel dyed and marked in accordance with §48.4082-1(b) and (c).

(3) Diesel fuel that is dyed one color in accordance with §48.4082-1(b) is blended with diesel fuel that is dyed another color in accordance with §48.4082-1(b).

(4) Diesel fuel that does not satisfy the dyeing and marking requirements of §48.4082-1(b) and (c) is blended with diesel fuel that satisfies the dyeing and marking requirements of §48.4082-1(b) and (c) and the blending occurs as part of a use described in §48.4082-4(c) or §48.6427-8(b)(vi)(C), (D), or (E).

(b) *Effective date.* This section is effective January 1, 1994.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 54. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 55. In §602.101, paragraph (c) is amended as follows:

1. Removing the following entries from the table:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control number
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* * * * *

42.5(b)	1545-1206
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48.4041-2T	1545-0143
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48.4082-2T	1545-1418
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48.4101-1	1545-0023
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1545-0725

1545-0014

48.4101-2T	1545-0725
----------------------	-----------

48.4101-3T	1545-1418
----------------------	-----------

48.4101-4T	1545-1418
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48.6427-8T	1545-1418
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48.6427-9T	1545-1418
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* * * * *

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

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control number
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48.4082-2	1545-1418
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48.4101-1	1545-1418
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48.4101-2	1545-1418
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48.6427-8	1545-1418
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48.6427-9	1545-1418
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* * * * *

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 18, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 13, 1996, 8:45 a.m., and published in the issue of the Federal Register for March 14, 1996, 61 F.R. 10450)

Part III. Administrative, Procedural, and Miscellaneous

Debt Instruments Subject to Both § 475 and the Principal-Reduction Method of Accounting

Notice 96-23

The Internal Revenue Service is concerned that the principal-reduction method of accounting for *de minimis* original issue discount (OID) on loans originated by the taxpayer, *see* Rev. Proc. 94-29, 1994-1 C.B. 616, may be used to claim inappropriate tax treatment under the mark-to-market rules of § 475 of the Internal Revenue Code. Accordingly, the Internal Revenue Service requests comments regarding the proper accounting for loans that are subject to both the principal-reduction method of accounting and the mark-to-market rules.

BACKGROUND

A loan is originated with a *de minimis* amount of OID if the loan's stated redemption price at maturity exceeds the issue price of the loan by less than a certain amount (for example, 0.25 percent of a loan's stated redemption price at maturity multiplied by the number of complete years from its issue date to its maturity date). Section 1273(a)(3) and § 1.1273-1(d) of the Income Tax Regulations.

If a loan is originated with a *de minimis* amount of OID, the lender generally includes the *de minimis* OID (other than any *de minimis* OID treated as qualified stated interest) in income as principal payments are made. § 1.1273-1(d)(5). As a matter of taxpayer convenience, Rev. Proc. 94-29 authorizes the use of an aggregate method of accounting (the principal-reduction method) for *de minimis* OID on certain loans originated by a taxpayer. In general, under the principal-reduction method, the portion of the aggregate *de minimis* OID that is taken into account in a taxable year is determined on a monthly basis. The portion is the ratio of the stated principal that is recovered during each month to the sum of the stated principal that is outstanding at the start of the month plus the stated principal on loans originated during the month. Principal is treated as recovered when principal payments are made, when

loans are written off in whole or in part, and when loans are sold or exchanged.

A taxpayer's unadjusted basis in a loan originated with a *de minimis* amount of OID generally is the issue price of the loan. If the loan is accounted for under the principal-reduction method, however, the taxpayer's unadjusted basis in the loan is deemed to be the loan's stated principal amount, which is greater than the loan's issue price. This basis increase assures that all of the gain represented by the *de minimis* OID is recognized solely under the principal-reduction method. *See* section 5.01 of Rev. Proc. 94-29.

Section 475 requires a dealer in securities to use the mark-to-market method of accounting for certain securities, including certain loans. Under this method, a security that is inventory in the hands of a dealer is included in inventory at its fair market value. Any other security subject to § 475 is treated as sold at its fair market value on the last business day of the taxable year, with any resulting gain or loss taken into account by the dealer in the taxable year of the deemed sale.

The Service is considering the proper application of the mark-to-market rules to a loan that is being accounted for under the principal-reduction method. As a result of its consideration to date, the Service has concluded that a taxpayer may not take the basis increase provided under Rev. Proc. 94-29 into account for mark-to-market purposes and, at the same time, treat the principal on the marked loan as outstanding at the end of a monthly computation period (and thus not recovered) for purposes of Rev. Proc. 94-29. This approach would distort the taxpayer's income by allowing the taxpayer to create an artificial loss under § 475 or to avoid recognition under § 475 of all or a portion of the appreciation on the loan. In either case, this distortion is attributable solely to the basis increase provided under section 5.01 of Rev. Proc. 94-29.

The Service is considering a number of alternatives for reconciling mark-to-market accounting and the principal-reduction method. Under one alternative, the entire principal on a loan that is subject to § 475 would be treated as

recovered for purposes of Rev. Proc. 94-29 on the first date on which the loan is required to be marked to market, and the loan would not thereafter be treated as outstanding for purposes of the principal-reduction computation under Rev. Proc. 94-29. Under another alternative, the gain or loss from marking a loan to market under § 475 would be determined without regard to the basis increase provided under section 5.01 of Rev. Proc. 94-29.

REQUEST FOR COMMENTS

The Service requests comments on the most appropriate method of accounting for loans that are subject to both § 475 and the principal-reduction method of accounting, including whether an aggregate method of marking loans to market in this circumstance is feasible and desirable.

Written comments should be sent in duplicate no later than July 15, 1996 to: CC:DOM:FI&P, Room 4300, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. The Service will make these comments available for public inspection.

CONTACT PERSON

This notice was drafted in the Office of Assistant Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Albert J. Kiss at (202) 622-3940 (not a toll-free call).

Weighted Average Interest Rate Update

Notice 96-24

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103-465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for March 1996 is 6.60 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 108% Permissible Range	90% to 110% Permissible Range
April	1996	6.95	6.26 to 7.51	6.26 to 7.65

Drafting Information

The principal author of this notice is Donna Prestia of the Employee Plans Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 4:00 p.m. Eastern time (not a toll-free number). Ms. Prestia's number is (202) 622-7377 (also not a toll-free number).

26 CFR 601.202: Closing agreements.

Rev. Proc. 96-29

SECTION 1. PURPOSE

.01 This revenue procedure modifies Rev. Proc. 94-62, 1994-2 C.B. 778, which describes the Voluntary Compliance Resolution (VCR) Program, and Rev. Proc. 94-16, 1994-1 C.B. 576, which describes the Walk-in Closing Agreement Program (Walk-in CAP), to change the definition of when a plan is ineligible for those programs because it is under examination. The modification conforms the definition to that set forth in Rev. Proc. 95-24, 1995-1 C.B. 694, which describes the Tax Sheltered Annuity Voluntary Correction (TVC) Program.

.02 This revenue procedure also modifies Rev. Proc. 94-62 to provide that a plan that is submitted under the VCR program on or after January 1, 1996, will not be considered ineligible for the VCR program solely by reason of its not having received a favorable determination letter that considers the Tax Reform Act of 1986 (TRA '86) if certain conditions have been met at the time of the plan's submission under the VCR program. These conditions require that the plan have received a favorable letter that considers the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), the Deficit Reduction Act of 1984 (DEFRA), and the Retirement Equity Act of 1984 (REA), and, at the time of its VCR submission, have been submitted within the plan's § 401(b) remedial amendment period for a determination letter that considers TRA '86.

Those plans for which the § 401(b) remedial amendment period has not expired (including adopters of certain master and prototype plans, regional prototype plans, volume submitter plans, governmental plans, and plans maintained by tax-exempt organizations), may be submitted for consideration under the VCR program on or after January 1, 1996, if the plan is the subject of a favorable letter that considers TEFRA, DEFRA, and REA.

SECTION 2. BACKGROUND

.01 The Internal Revenue Service has developed a number of voluntary compliance programs over the past several years for plans, annuities, or other arrangements ("plans") qualified under § 401(a), or described in § 403(b), of the Code. Under each of these programs, the employer corrects defects in the plan for all years and the Service treats the plan as qualified under § 401(a), or as satisfying § 403(b), with respect to those defects. Plans submitted under these compliance programs must meet certain eligibility requirements.

.02 *Background concerning eligibility of plans under examination for the VCR program, Walk-in CAP, and the TVC program.*

(1) *VCR program.* On November 16, 1992, the Service established the VCR program as a temporary, experimental program, that was later extended indefinitely with the publication of Rev. Proc. 94-62. The VCR program permits plan sponsors to pay a fixed compliance fee and correct operational qualification defects in their § 401(a) plans. Regarding the eligibility of plans under examination, section 4.07 of Rev. Proc. 94-62 provides in part that "[a] plan that is under an Employee Plans examination (that is, an examination of a Form 5500 series return) is not eligible for the VCR program. A plan that is under an Employee Plans examination includes any plan for which the plan sponsor, or a representative, has received verbal or written notification from the EP/EO

Division of an impending Employee Plans examination."

(2) *Walk-in CAP.* On January 31, 1994, the Service established Walk-in CAP with the publication of Rev. Proc. 94-16. Walk-in CAP permits plan sponsors of § 401(a) plans that are not eligible for the VCR program to pay a negotiated, limited, monetary sanction and correct form and operational qualification defects. Participation in Walk-in CAP must be voluntary. Section 3.06 of Rev. Proc. 94-16 provides in part that "a request is voluntary if it is made before the plan sponsor, or a representative, has received verbal or written notification from the EP/EO Division of an impending Employee Plans examination."

(3) *Voluntary compliance program for § 403(b) plans.* On May 1, 1995, the Service established the TVC program as a temporary, experimental program pursuant to Rev. Proc. 95-24. The TVC program will sunset on October 31, 1996. The TVC program permits plan sponsors to correct defects in their § 403(b) plans, and to pay a fixed correction fee and a negotiated sanction. Section 5.04 of Rev. Proc. 95-24 provides in part that "a 403(b) plan that is under Employee Plans or Exempt Organization examination (that is, an examination of a Form 5500 series, a Form 990 series or other Employee Plans or Exempt Organizations examination) is not eligible for the program. This includes any plan for which the employer, or a representative, has received verbal or written notification from the EP/EO Division of an impending Employee Plans or Exempt Organizations examination."

.03 *Background concerning eligibility for the VCR program of plans that do not have a favorable determination, opinion, or notification letter for TRA '86.*

(1) Section 4.02 of Rev. Proc. 94-62 provides that the VCR program is available only for an individually designed plan that has reliance on a favorable determination letter, a plan that is an adopter of a master or prototype plan with an opinion letter,

or a plan that is an adopter of a regional prototype plan with a notification letter. Under section 4.02(2) of that revenue procedure, for VCR requests submitted on or after January 1, 1996, a plan must have received a favorable determination, opinion, or notification letter that takes into account TRA '86.

(2) Section 13.05 of Rev. Proc. 94-62 provides that a plan's VCR submission must be accompanied by certain documents. These include a copy of the determination letter that considered TEFRA, DEFRA, and REA, and any subsequent letter. After December 31, 1995, the letter must have considered TRA '86.

(3) Rev. Proc. 95-12, 1995-1 C.B. 508, extends the deadline by which employers may request determination letters for certain plans and be considered to have amended their plans timely to comply with TRA '86. Under Rev. Proc. 95-12, the filing of a determination letter request for certain plans within three months after the end of the plan's remedial amendment period (as modified therein) is treated as having been filed on or before the end of the plan's remedial amendment period. In addition, Rev. Proc. 95-12, at section 3, extends the remedial amendment period for adopters of certain regional prototype, master and prototype, and volume submitter plans that comply with TRA '86 to, in general, six months after a favorable letter is issued with respect to the plan.

(4) Announcement 95-48, 1995-23 I.R.B. 13, extends the remedial amendment period for governmental plans described in § 414(d) to the last day of the first plan year beginning on or after the later of January 1, 1999, or 90 days after the opening of the first legislative session beginning on or after January 1, 1999, of the governing body with authority to amend the plan, if that body does not meet continuously. Announcement 95-48 also extends the remedial amendment period for plans maintained by organizations exempt from income tax under § 501(a), other than non-electing church plans described in § 410(c)(1)(B), to the last day of the first plan year beginning on or after January 1, 1997. For non-electing church plans, Announcement 95-48 extends the remedial amendment period to the last day of the first plan year beginning on or after January 1, 1999.

SECTION 3. DEFINITION OF PLAN UNDER EXAMINATION

.01 Section 4.07 of Rev. Proc. 94-62 is hereby modified to read as follows:

.07 *Plans under examination.* If a plan or plan sponsor is under an Employee Plans or Exempt Organizations examination (that is, an examination of a Form 5500 series, a Form 990 series or other Employee Plans or Exempt Organizations examination) the plan is not eligible for the VCR program.

(1) A plan or plan sponsor that is under an Employee Plans or Exempt Organizations examination includes any plan for which the employer, or a representative, has received verbal or written notification from the EP/EO Division of an impending Employee Plans or Exempt Organizations examination, or of an impending referral for Employee Plans or Exempt Organizations examination, and also includes any plan that has been under an Employee Plans or an Exempt Organizations examination and is now in Appeals or in litigation for issues raised in the Employee Plans or Exempt Organizations examination.

(2) An Employee Plans examination also includes a case in which a plan sponsor has submitted a Form 5310, Application for Determination of Qualification Upon Termination, and the EP Agent notifies the plan sponsor, or a representative, of possible defects, whether or not the plan sponsor is officially notified of an "examination." For example, if an employer has applied for a determination letter on plan termination, and an EP Agent notifies the employer that there are partial termination concerns, the plan is no longer eligible for the VCR program.

(3) The VCR program is available with respect to any other plan of the plan sponsor that is not aggregated for purposes of satisfying the qualification requirements of § 401(a), or the requirements of § 403(b), with the plan (or plans) under examination. In addition, the VCR program is available for a plan that is aggregated with a plan that is under an Employee Plans examination with respect to a defect that is not related to provisions for which the plans are aggregated. Thus, for example, a plan sponsor of a plan aggregated with a plan that is under examination could request considera-

tion under the VCR program for a defect arising under the spousal consent rules of § 417, or the vesting rules of § 411, but could not ask for consideration of a defect under provisions for which the plans are aggregated, including the nondiscrimination provisions (§§ 401(a)(4), 410(b), etc.), § 415, or § 416. For purposes of this revenue procedure, the term aggregation does not include consideration of benefits provided by various plans for purposes of the average benefits test set forth in § 410(b)(2).

.02 Section 3.06 of Rev. Proc. 94-16 is hereby modified to read as follows:

.06 If a plan or plan sponsor is under an Employee Plans or Exempt Organizations examination (that is, an examination of a Form 5500 series, a Form 990 series or other Employee Plans or Exempt Organizations examination) the plan is not eligible for voluntary consideration under CAP.

(1) A request for consideration under CAP is voluntary if it is made before the plan sponsor, or a representative, has received verbal or written notification from the EP/EO Division of an impending Employee Plans or Exempt Organizations examination, or of an impending referral for Employee Plans or Exempt Organizations examination, and also includes any plan that has been under an Employee Plans or an Exempt Organizations examination and is now in Appeals or in litigation for issues raised in the Employee Plans or Exempt Organizations examination.

(2) A request for consideration under CAP will not be considered voluntary if it is made as part of a determination letter application.

(3) An Employee Plans examination also includes a case in which a plan sponsor has submitted a Form 5310, Application for Determination of Qualification Upon Termination, and the EP Agent notifies the plan sponsor, or a representative, of possible defects, whether or not the plan sponsor is officially notified of an "examination." For example, if an employer has applied for a determination letter on plan termination, and an EP Agent notifies the employer that there are partial termination concerns, a request for consideration under CAP will not be considered voluntary.

(4) Walk-in CAP is available with respect to any other plan of the plan sponsor that is not aggregated for

purposes of satisfying the qualification requirements of § 401(a), or the requirements of § 403(b), with the plan (or plans) under examination. In addition, Walk-in CAP is available for a plan that is aggregated with a plan that is under an Employee Plans examination with respect to a defect that is not related to provisions for which the plans are aggregated. Thus, for example, a plan sponsor of a plan aggregated with a plan that is under examination could voluntarily request consideration under CAP for a defect arising under the spousal consent rules of § 417, or the vesting rules of § 411, but could not ask for consideration of a defect under provisions for which plans are aggregated, including the non-discrimination provisions (§§ 401(a)(4), 410(b), etc.), § 415, or § 416. For purposes of this revenue procedure, the term aggregation does not include consideration of benefits provided by various plans for purposes of the average benefits test set forth in § 410(b)(2).

SECTION 4. PLANS THAT HAVE NOT YET RECEIVED A TRA '86 LETTER

.01 Section 4.02(2) of Rev. Proc. 94-62 is hereby modified to read as follows:

For VCR requests submitted on or after January 1, 1996, the plan must (1) have received a favorable determina-

tion, opinion, or notification letter that considered TEFRA, DEFRA, and REA, and, (2) at the time of the request, have been submitted within the plan's § 401(b) remedial amendment period for a determination, opinion, or notification letter that considers TRA '86 (TRA '86 remedial amendment period). This second condition does not apply in the case of plans for which the TRA '86 remedial amendment period has not yet expired, such as adopters of master and prototype plans, regional prototype plans, and volume submitter plans, described in section 3 of Rev. Proc. 95-12; governmental plans described in Announcement 95-48; and plans maintained by tax-exempt organizations, including non-electing church plans, described in Announcement 95-48.

.02 Section 13.05(3) of Rev. Proc. 94-62 is hereby modified to read as follows:

(3) A copy of the determination letter, opinion letter, or notification letter that considered TEFRA, DEFRA, and REA, and any subsequent letter. For VCR requests submitted after December 31, 1995, either the letter must have considered TRA '86 or the following additional documentation must be supplied:

(a) For individually designed plans (including volume submitter plans) for which the TRA '86 remedial amendment period under § 401(b) has expired, but which have not yet received a favorable determination letter

that considers TRA '86, a copy of the letter acknowledging receipt of the TRA '86 determination letter application (Form 2693).

(b) For plans for which the TRA '86 remedial amendment period has not yet expired, a statement that explains the reason why the period has not yet expired (for example, because the plan is a governmental plan, or because it is an adopter of a master or prototype plan that is still entitled to continued or interim reliance under Rev. Proc. 89-9, 1989-1 C.B. 780).

SECTION 5. EFFECTS ON OTHER DOCUMENTS

Rev. Proc. 94-16 and Rev. Proc. 94-62 are modified.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective on April 15, 1996.

DRAFTING INFORMATION

The principal author of this revenue procedure is Diane S. Bloom of the Employee Plans Division. For more information concerning this revenue procedure, call the Employee Plans Division VCR telephone number (202) 622-8165 (not a toll-free number). Ms. Bloom may be reached at (202) 622-6214 (also not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Gasoline and Diesel Fuel Excise Tax; Dye Injection Systems and Markers; Measurement

PS-6-95

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the gasoline and diesel fuel excise tax. The proposed regulations reflect and implement certain changes made by the Revenue Reconciliation Act of 1990 and the Omnibus Budget Reconciliation Act of 1993 (the 1993 Act). They affect certain enterers, refiners, terminal operators, and throughputters. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written comments and outlines of oral comments to be presented at the public hearing scheduled for June 20, 1996, must be received by June 12, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (PS-6-95), 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 (PS-6-95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. The public hearing will be held in the IRS Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Frank Boland, (202) 622-3130; concerning submissions and the hearing, Christina Vasquez at (202) 622-7190; (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed

rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507).

Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the 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 May 13, 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 §48.4082-1(c). This information is required by the IRS to monitor manual dyeing at terminals. This information will be used to ensure the collection of the proper amount of tax imposed by section 4081. The likely recordkeepers are business or other for-profit institutions and organizations. Responses to this collection of information are required to obtain exemption from the diesel fuel excise tax.

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 recordkeeping burden: 200 hours.

Estimated average annual burden per recordkeeper: 1 hour.

Estimated number of recordkeepers: 200.

Background

Section 4081 imposes a tax on certain removals, entries, and sales of diesel fuel. However, under section 4082, the tax is not imposed if, among other conditions, the diesel fuel (1) is indelibly dyed in accordance with regulations that the Secretary shall prescribe, and (2) meets such marking requirements (if any) as may be prescribed by the Secretary in regulations.

The regulations currently provide that the section 4082 exemption applies only to diesel fuel that contains a prescribed type and amount of dye. However, the regulations do not prescribe the time or method for adding the dye to diesel fuel and do not require the use of a marker.

Dye injection systems

Dyeing methods. Diesel fuel is usually dyed at a terminal rack by either manual dyeing or mechanical injection.

At a terminal using a typical manual dyeing technique, a measured amount of dye is manually placed into an empty tank compartment of a transport trailer while the trailer is at the terminal rack. Then, as diesel fuel is pumped into the compartment at the rack, the dye and the fuel are mixed together. Further mixing occurs through the motion of the trailer as it moves on the highway.

At a terminal using a typical mechanical injection system, a measured amount of dye is automatically injected into the diesel fuel as the fuel is delivered into a compartment of a transport trailer at the terminal rack.

Concerns about manual dyeing. The Federal government, State governments, and various segments of the petroleum industry have long been concerned with the problem of diesel fuel tax evasion, and to address this problem Congress changed the law to require that untaxed diesel fuel be indelibly dyed. The IRS is concerned, however, that tax can still be evaded through removals at a terminal of undyed fuel that has been designated as dyed.

Manual dyeing is inherently difficult to monitor. It occurs after diesel fuel has been withdrawn from a terminal storage tank, generally requires the work of several people, is imprecise, and does not automatically create a reliable record.

Mechanical dye injection, on the other hand, occurs while the fuel is still under the control of the terminal operator, is computer regulated, and can automatically create a reliable record of the amount of dye that was injected and fuel that was dyed. Thus, dye injection is the preferred method of combining diesel fuel and dye at a terminal.

Explanation of provisions. Diesel fuel removed from a terminal at the rack may be dyed before the fuel is received at the terminal, while the fuel is in a bulk storage tank at the terminal, or at the terminal rack. Under the proposed regulations, as under existing law, diesel fuel must contain a prescribed type and amount of dye at the time of the removal, entry, or sale that would otherwise be subject to tax. For example, high-sulfur diesel fuel, which is required to be dyed at a refinery under Environmental Protection Agency regulations, must contain the prescribed type and amount of dye at the time of the removal at the terminal rack even if additional dye must be added at that point.

Under the proposed regulations, a terminal operator that dyes diesel fuel at a terminal generally must use a prescribed mechanical injection system or else give a bond to the district director as a condition of retaining its registration. The prescribed system contains calibrated measurement devices, shut-off devices, and locks and similar equipment to secure these devices. If the system malfunctions at a particular terminal, the terminal operator may manually dye the fuel if the operator notifies the district director of the malfunction.

The proposed regulations also prescribe the records that the terminal operator must maintain with respect to any manual dyeing performed at its terminals.

Markers

A marker is a material that is placed in diesel fuel to designate the fuel as untaxed. Unlike dye, a marker does not reveal its presence until the fuel into which it is introduced is subjected to a special test. Markers are effective even if diluted and can be detected even if there is no visual evidence of dye.

The proposed regulations do not require the use of markers. However, the IRS expects to issue a notice of proposed rulemaking with respect to markers within the next year. In the meantime, the IRS is interested in receiving comments relating to the type and concentration of markers, the cost of markers, and whether lower concentrations of dye could be used in conjunction with a marker.

Measurement

Existing regulations provide that gallons of taxable fuel may be measured on the basis of actual volumetric gallons, gallons adjusted to 60 degrees Fahrenheit, or any other temperature adjustment method approved by the Commissioner.

These proposed regulations modify this rule by generally providing that measurement is to be made on the basis of actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit, whichever is the basis for measurement under the position holder's terminaling agreement with the terminal operator.

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 has been scheduled for Thursday, June 20, 1996, at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the 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 and an outline of

topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by June 12, 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 regulations is Frank Boland, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 48 is proposed to be amended as follows:

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Paragraph 1. The authority citation for part 48 continues to read, in part, as follows:

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

Par. 2. Section 48.4081-8 is revised to read as follows:

§48.4081-8 Taxable fuel; measurement.

(a) *Removals from a terminal.* For purposes of the tax imposed under §§48.4081-2 and 48.4081-3(d), taxable fuel is measured on the basis of actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit, whichever is the basis for measurement under the position holder's terminaling agreement with the terminal operator.

(b) *Other taxable events.* For purposes of the taxes imposed under §§48.4081-3(b), 48.4081-3(c), 48.4081-3(e), and 48.4082-4, and the tax imposed on the removal of taxable fuel under §48.4081-3(g), taxable fuel is measured on the basis of actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit. For purposes

of the tax imposed under §48.4081-3(f) and the tax imposed on the sale of taxable fuel under §48.4081-3(g), taxable fuel is measured on the basis of actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit, whichever basis is used to invoice the buyer.

(c) *Effective date.* This section is applicable as of October 1, 1996.

Par. 3. Section 48.4082-1 is amended as follows:

1. In the introductory text of paragraph (a), the language “if—” is removed and “if, at the time of the removal, entry, or sale—” is added in its place.

2. Paragraph (d) is revised.

The revision reads as follows:

§48.4082-1 Diesel fuel tax; exemption.

* * * * *

(d) *Time for adding the dye and marker—(1) Removals from a terminal at the terminal rack; in general.* With respect to any removal from a terminal at the terminal rack, diesel fuel satisfies the dyeing and marking requirements of this paragraph (d) only if the dye and marker required by paragraphs (b) and (c) of this section are combined with diesel fuel—

(i) Before the fuel is received at the terminal;

(ii) While the fuel is in a bulk storage tank at the terminal; or

(iii) At the terminal rack by means of—

(A) A mechanical injection system described in paragraph (d)(2) of this section; or

(B) Nonconforming dyeing, under the conditions of paragraph (d)(3) of this section.

(2) *Removals from a terminal at the terminal rack; mechanical injection systems.* A mechanical injection system is described in this paragraph (d)(2) only if the district director has determined (and such determination has not been withdrawn) that the system contains—

(i) Features that automatically inject a measured amount of dye and marker into diesel fuel as the fuel is delivered into the transport compartment of a truck, trailer, railroad car, or other means of nonbulk transfer;

(ii) Calibrated devices that accurately measure and record the amount

of dye, marker, and fuel that is dispensed at the rack for each removal;

(iii) Shut-off devices that prevent the removal of more than 50 gallons of undyed diesel fuel in the case of a system malfunction; and

(iv) Locks or similar security equipment that secure the measurement devices and shut-off devices.

(3) *Removals from a terminal at the terminal rack; conditions for nonconforming dyeing.* Nonconforming dyeing meets the conditions of this paragraph (d)(3) only if diesel fuel is dyed and marked in the manner described in paragraph (d)(4) of this section and—

(i) The terminal operator has given a bond as a condition of registration under the provisions of §48.4101-1(f)(4)(i); or

(ii) In the case of a terminal containing a mechanical injection system described in paragraph (d)(2) of this section—

(A) The accurate mechanical injection of dye and marker at the terminal cannot occur because of an equipment malfunction or a shutdown for maintenance purposes;

(B) Before beginning any nonconforming dyeing described in paragraph (d)(4) of this section, the terminal operator notifies the district director of the time, location, and type of malfunction or maintenance shutdown; and

(C) Immediately after correction of the malfunction or completion of the maintenance, the terminal operator notifies the district director that mechanical injection has resumed.

(4) *Removals from a terminal at the terminal rack; description of nonconforming dyeing—(i) In general.* Diesel fuel is dyed and marked in a manner described in this paragraph (d)(4) only if the diesel fuel is dyed and marked by means of a mechanical injection system described in paragraph (d)(4)(ii) of this section or manual dyeing described in paragraph (d)(4)(iii) of this section.

(ii) *Mechanical injection.* Diesel fuel is dyed and marked in a manner described in this paragraph (d)(4)(ii) if the diesel fuel is dyed and marked by means of a mechanical injection system that is not described in paragraph (d)(2) of this section and, with respect to the diesel fuel so dyed and marked, the terminal operator maintains a record of—

(A) The identity and registration number of the position holder;

(B) The identity and taxpayer identification number of the individual that physically receives the fuel at the terminal;

(C) The identity and taxpayer identification number of any individual that physically operates the mechanical injection equipment; and

(D) The volume of the fuel dyed and marked and the date and time of the dyeing.

(iii) *Manual dyeing.* Diesel fuel is dyed and marked in a manner described in this paragraph (d)(4)(iii) if—

(A) The terminal operator places a dye and marker of the type and concentration required by paragraphs (b) and (c) of this section into a compartment of a truck, trailer, railroad car, or other means of nonbulk transfer;

(B) The diesel fuel is removed from the terminal at the rack and is immediately delivered into the compartment described in paragraph (d)(4)(iii)(A) of this section; and

(C) With respect to the diesel fuel so dyed and marked, the terminal operator maintains a record of—

(1) The identity and registration number of the position holder;

(2) The identity and taxpayer identification number of the individual that physically receives the fuel at the terminal;

(3) The identity and taxpayer identification number of the individual that physically places the dye and marker into the compartment described in paragraph (d)(4)(iii)(A) of this section; and

(4) The volume of the fuel dyed and marked and the date and time of the manual dyeing.

(5) *Removals from refineries, sales or entries.* With respect to any removal from a refinery, sale, or entry, diesel fuel satisfies the dyeing and marking requirements of this paragraph (d) only if the dye and marker required by paragraphs (b) and (c) of this section are combined with diesel fuel before the removal, sale, or entry that would otherwise be subject to the tax imposed by section 4081. Thus, for example, diesel fuel that is entered into the United States by means of nonbulk transfer (such as in a railroad car) does not satisfy the requirements of this paragraph (d)(5) if the required dye and marker are combined with the diesel fuel after the fuel has been entered into the United States.

(6) *Cross reference.* For rules allowing inspection of equipment used for the dyeing of fuel, see section 4083.

(7) *Effective date.* This paragraph (d) is applicable as of April 1, 1997.

* * * * *

Par. 4. Section §48.4101-1 is amended as follows:

1. Paragraph (b)(7) is added.

2. Paragraph (f)(4)(i) is amended by adding a sentence at the end of the paragraph.

3. In the first sentence of paragraph (j)(2) introductory text, the language "A bond" is removed and "Except as provided in the last sentence of paragraph (f)(4)(i) of this section, a bond" is added in its place.

4. Paragraph (l)(4) is added.

The additions read as follows

§48.4101-1 Registration.

* * * * *

(b) * * *

(7) *Nonconforming dyeing amount.* The *nonconforming dyeing amount* is the product of—

(i) The rate of tax on diesel fuel provided by section 4081(a)(2); and

(ii) An amount up to the total number of gallons of diesel fuel expected to be dyed by nonconforming dyeing (and removed at terminal racks of the applicant that do not have a mechanical injection system described in §48.4082-1(d)(2)) during a representative one-month period (as determined by the district director).

* * * * *

(f) * * *

(4) * * * (i) * * * An applicant that operates a terminal where diesel fuel is dyed by nonconforming dyeing (and removed at a rack that is not equipped with a mechanical injection system described in §48.4082-1(d)(2)) meets the adequate security test only if the applicant has given a bond (in addition to any bond given under paragraph (j) of this section) equal to the nonconforming dyeing amount.

* * * * *

(l) * * *

(4) The last sentence of paragraph

(f)(4)(i) of this section is applicable as of April 1, 1997.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 13, 1996, 8:45 a.m., and published in the issue of the Federal Register for March 14, 1996, 61 F.R. 10490)

Exempt Organizations; Proposed Examination Guidelines Regarding Rural Electric Cooperatives

Announcement 96-24

PURPOSE

The Internal Revenue Service has developed proposed examination guidelines for Exempt Organizations Internal Revenue Agents to use during the examinations of rural electric cooperatives. These guidelines are intended to provide a framework that agents can follow in conducting the examination. Because they address matters that may have a significant impact on rural electric cooperatives, the Service is soliciting public comments on them. The guidelines will be published in the Internal Revenue Manual.

BACKGROUND

These guidelines offer suggestions on issues, documents and techniques for examining rural electric cooperatives. They do not attempt to cover every issue that might arise in an examination. They are not intended to require examiners to exhaustively review all areas described in each rural electric cooperative examination.

PROPOSED EXAMINATION GUIDELINES

(12)20 Specific Examination Guidelines

(12)21 Rural Telephone Cooperatives [Reserved]

(12)22 Rural Electric Cooperatives

These guidelines offer suggestions on issues, documents and techniques for examining rural electric cooperatives. They do not attempt to cover every issue that might arise in an

examination. Conversely, some issues in these guidelines will not arise in every examination. Examinations of generation and transmission cooperatives and distribution and transmission cooperatives, for example, present different issues. Further, these guidelines are not intended to require examiners to exhaustively review all areas described in examining every rural electric cooperative. Examiners or case managers should use their professional judgment to determine the scope and depth of each examination.

(12)22.1 Introduction: Electric Utilities and Rural Electric Cooperatives

(1) *Electric Utilities.* Electric utilities (including rural electric cooperatives) were once monopolies. Now they confront many challenges including increased competition from their own consumers, independent power producers and other electric utilities. Electricity is becoming a commodity. Industry and government consumers demand electricity at the lowest cost and increasingly, if dissatisfied with rates from the local electric utility, they may build their own generating plants (and bypass the electric utility altogether) or purchase electricity from another electric utility (to be transmitted over the local utility's power lines (retail wheeling)). Other changes in economics and technology are challenging electric utilities. Demand for electricity is growing, only slowly, thereby holding down revenues (as are stranded investments). Further, it remains to be decided what role electric utilities will play in developing the information superhighway. Legislatures and regulatory agencies are responding to these questions.

(2) *Trends.* Industry analysts forecast several trends: more price wars between competing utilities, more mergers among electric utilities, (including generation and transmission cooperatives (G&Ts)); more joint ventures between cooperatives and other utilities to own and operate power generation plants; and more sharing of services. This environment will very likely generate new accounting and tax questions.

(3) *Rural Electric Cooperatives.* Rural electric cooperatives (cooperatives) provide electric power to members and other consumers. G&Ts construct and operate power plants (alone

or in arrangements with other utilities) and sell electricity at wholesale to their member distribution cooperatives, which in turn, sell electricity retail to consumers. Distribution cooperatives are members of G&T cooperatives. The distribution cooperatives purchase electricity from their G&T to furnish electricity to consumers. Each cooperative, in turn, may be a member of other cooperatives, including cooperative subsidiaries. To carry out their activities, G&Ts and distribution cooperatives acquire land and land rights (including easements, water and power rights, diversion rights, submersion rights). They own (or lease) and operate electric generating plant and transmission and distribution plant, office space, furniture and equipment. 7 C.F.R. § 1767.16. Cooperatives also contract for fuel, power supply and operate power plants jointly with other utilities. See GAO Reports *REA Borrowers' Investment in Cable and Satellite Television Services*, RCED-93-164 (1993); *Legislation Needed to Improve Administration of Tax Exemption Provisions For Electric Cooperatives*, GGD-83-7 (1983). On the history and background of rural electric cooperatives, see *Exempt Organizations Handbook*, "Local Benevolent Life Insurance Association, Mutual Ditch, Irrigation and Telephone Companies, and Like Organizations," ch. 12(00).

(4) Joint Ventures. G&Ts often join with other electric utilities to build and operate power generating stations. The joint venturers may own the station as tenants in common, operating the station and sharing its capacity and energy according to various operating agreements, station agreements and load management agreements. These joint ventures may raise issues bearing on the 85 percent test. See generally, *Specialized Industry Audit Guidelines—Public Utilities (Utilities Handbook)* § 240.

(5) Diversification. Cooperatives are diversifying, offering water management, sewage treatment, venturing into economic development, offering satellite television service and selling satellite reception equipment (and, less commonly, offering cable television service). Many cooperatives belong to the National Rural Telecommunications Cooperative (NRTC) which offers Rural TV programming on the satellite C-band. NRTC also plans to offer Direct TV (which uses different re-

ceivers) on the satellite Ku-band. Many of these satellite and cable television services are for-profit (noncooperative) businesses. GAO Report RCED-93-164.

(12)22.2 Overview—IRC 501(c)(12)

(1) Background on Electric Cooperatives. See *Exempt Organizations Handbook*, "Local Benevolent Life Insurance Association, Mutual Ditch, Irrigation and Telephone Companies, and Like Organizations," ch. 12(00); "Taxation of Cooperatives," ch. (45)10, *Utilities Handbook*, including Exhibits 200-2, Index of Revenue Rulings and 200-3 Index of Court Cases and *Examination Guidelines Handbook*, "Local Benevolent Life Insurance Association, Mutual Ditch, Irrigation and Telephone Companies, and Like Organizations—IRC 501(c)(12)," ch. (12)10.

(2) Requirements for Exemption. Mutual ditch or irrigation companies, mutual or cooperative telephone companies and like organizations are exempt from federal income tax under IRC 501(c)(12) if 85 percent or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses (the 85 percent test). To be exempt, cooperatives must be:

- (a) like organizations;
- (b) operate under cooperative principles; and
- (c) meet the 85 percent test.

(1) Like Organizations and Not Like Organizations. Rural electric cooperatives and cable television services operating on a cooperative basis are like organizations described in IRC 501(c)(12). Rev. Ruls. 67-265, 1967-2 C.B. 205; 83-170, 1983-2 C.B. 97. See also, *Exempt Organizations Handbook*, Chapter (12)33. The following are not like organizations:

(a) Cooperative organizations formed by electric cooperatives to finance their customers' purchases of electrical, water or plumbing appliances. *Consumers Credit Rural Electric Cooperative Corp. v. Commissioner*, 319 F.2d 475 (6th Cir. 1963);

(b) Cooperatives whose sole activity is selling electrical materials, equipment and supplies and furnishing equipment manufacturing,

testing and repair services, although all the members are cooperatives. Rev. Rul. 65-201, 1965-2 C.B. 170.

(c) Nonprofit automobile clubs furnishing travel and other services to members. *New Jersey Automobile Club v. United States*, 181 F. Supp. 259 (Cl. Ct. 1960), *cert. denied*, 366 U.S. 964 (1961);

(d) Housing cooperatives. Rev. Rul. 65-201, 1965-2 C.B. 170; and

(e) Organizations selling electrical materials, equipment and supplies and manufacturing, repairing or testing for members. Rev. Rul. 65-201, 1965-2 C.B. 170.

(2) Cooperatives Engaged in IRC 501(c)(12) and Non-IRC 501(c)(12) Activities. If a cooperative engages in activities described in IRC 501(c)(12) and in activities not described in IRC 501(c)(12), the examiner should determine whether the latter activities are insubstantial or are conducted incident to and in furtherance of IRC 501(c)(12) activities.

(3) Cooperative Principles. Cooperatives must operate according to the following principles:

(a) subordination of capital in control over the cooperative undertaking and in ownership of the financial benefits from ownership (unlike stockholders who earn a return on capital invested);

(b) democratic control by the members of the cooperative;

(c) vesting in and allocation among the members of all excess of operating revenues over the expenses incurred to generate revenues in proportion to their participation in the cooperative (patronage) (unlike stockholders who own equal shares in a corporation's net worth, regardless of how much business they transact (if any) with the corporation); and

(d) operation at cost (not operating for profit or below cost).

Puget Sound Plywood, Inc. v. Commissioner, 44 T.C. 305, 308 (1965), *acq.*, 1966-2 C.B. 6; *Mutual Fire Ins. Co. of Germantown, Inc. v. United States*, 142 F.2d 344 (3d Cir. 1944), *cert. denied* 323 U.S. 729 (1945); *Keystone Auto. Club Casualty Co. v. Commissioner*, 122 F.2d 886 (3d Cir. 1941), *cert. denied*, 315 U.S. 814 (1942). See generally, parallel provisions in IRC 521 and Treas. Reg. § 1.521-1.

(e) Cooperative Principles Applied to IRC 501(c)(12). Rev. Rul. 72-36, 1972-1 C.B. 151 holds that IRC 501(c)(12) cooperatives must comply with fundamental cooperative principles. Because a cooperative must operate at cost, it must not accumulate cash reserves exceeding its reasonable needs. Any unneeded funds must be returned to members as patronage dividends. The rights of members in the cooperative's patronage capital account (the balance sheet account approximating retained earnings) must be determined on the basis of members' patronage throughout their years of membership. The cooperative must at all times keep records of members' rights to these assets and make distributions accordingly when the cooperative retains a reasonable cash reserve, when a member withdraws from the cooperative and when the cooperative realizes gains on sale of appreciated assets prior to dissolution. Rev. Rul. 78-238, 1978-1 C.B. 161.

(f) Maintaining Exemption. A substantial departure from democratic ownership, operation and control may warrant revocation of exemption (e.g., activities that would constitute private inurement or impermissible private benefit as defined in IRC 501(c)(3)). Cf. *Keystone Auto. Club Casualty Co. v. Commissioner*, 122 F.2d 886 (3d Cir. 1941).

(12)22.3 The 85 Percent Member Income Test

(1) General Principles. The following rules apply:

(a) Annual Testing. The 85 percent test must be computed in each taxable year. A cooperative may fail the test one year but meet the test in a prior or subsequent year. Rev. Rul. 65-99, 1965-1 C.B. 242. The test is applied using the cooperative's method of accounting. Rev. Rul. 68-18, 1968-1 C.B. 271. See also IRC 451(f) and IRC 166 discussed at (12)22(16).

(b) Gross Receipts or Gross Income. (Safe Harbor Guidelines) Prop. Treas. Reg. § 1.501(c)(12)-2 (49 Fed. Reg. 1244 (January 10, 1984)) would have determined the income from sale of electricity by subtracting the cost of goods sold

(computed according to Treas. Reg. § 1.471-11) from gross sales. The preamble to the proposed regulations stated that the regulations would be effective for taxable years beginning after the date of publication of final regulations and that in prior years, cooperatives may continue to apply the 85 percent test using the method that they consistently used in the past. The proposed regulations were withdrawn (58 Fed. Reg. 25587 (April 27, 1993)). Under the Safe Harbor Guidelines, cooperatives may continue to use the method they have consistently used in the past. If the cooperative computes member income using the gross receipts method, the cooperative should use the same method to compute non-member income.

(c) No Netting. Gross income derived from a transaction with a third party cannot be offset by amounts owed to that third party. Rev. Rul. 65-174, 1965-2 C.B. 169; Rev. Rul. 74-362, 1974-2 C.B. 131, *obsoleted in* Rev. Rul. 81-291, 1981-2 C.B. 131.

(d) No Reductions. Rents, dividends and interest must be included in gross income without reduction.

(2) Members vs. Nonmembers. Cooperatives may have several types of members. In general, members are those entitled to voice in management of the cooperative and to share in patronage capital. Rev. Rul. 78-238, 1978-1 C.B. 161. If the cooperative has more than one type or class of "members," ascertain which are members as defined in IRC 501(c)(12). A municipal corporation may be a member or nonmember. Rev. Rul. 68-75, 1968-1 C.B. 271. G&Ts may have members that are not distribution cooperatives.

(3) Classifying Income as Member or Nonmember Income. Each transaction for which income is realized must be classified as member income, non-member income or excluded income. Member income is member-sourced and derived from activities conducted according to cooperative principles. IRC 501(c)(12); Rev. Rul. 72-36, 1972-1 C.B. 151; Rev. Rul. 78-238, 1978-1 C.B. 161; Rev. Rul. 80-86, 1980-1 C.B. 118. Common transactions include:

(a) Sale of Electricity. Income from sale of electricity may be member or nonmember income, de-

pending on the membership status of the purchaser/consumer.

(b) Power Pooling Arrangements and Power Interchange Agreements. These agreements may generate member or nonmember income. Payments received by a cooperative under an arrangement with a commercial power company to operate the cooperative's generator unit constitute income to be considered in calculating whether the cooperative meets the 85 percent test. The cooperative may contend that the arrangement is merely an interchange of power involving no income or revenue for either party. Rev. Rul. 65-174, 1965-1 C.B. 242.

(c) Income from sale and service of appliances to nonmembers who purchase no electricity from the cooperative is nonmember income, even if the sales are made through agents or subsidiaries. (See (12)22.4(2) for treatment as unrelated business taxable income.)

(d) Interest Income. Interest income is often nonmember income because the source/payor of the interest is a nonmember. Transactions yielding interest income include:

(1) Interest Income from the Installment Sale of an Office Building. This is nonmember income. Cf. Rev. Rul. 65-99, 1965-1 C.B. 242 (holding that a cooperative must account for gain on an installment sale of property to a nonmember as nonmember income on a year-by-year basis).

(2) Interest Income from Sale/Leaseback of Cooperative's Assets. Interest income received by an exempt cooperative in sale/leaseback transaction (including safe harbor leases described in former IRC 168(f)(8)) is nonmember income.

(e) Discharge of Indebtedness Income. This income may be non-member income or excluded income. See (12)22.3(4)(c) and (12)22.3(3)(g).

(f) Rent. Leasing a power generating station to a nonmember utility from which the cooperative purchases power results in nonmember rental income. Rev. Rul. 65-174, 1965-2 C.B. 169. See below for qualified pole rentals.

(g) Original Issue Discount and Cancellation of Indebtedness Income

Resulting from Modification of Debt Instruments. Cooperatives enter into agreements under which the terms of their long-term debt are modified. For example, under section 12 of the Rural Electrification Act of 1936, REA is authorized to allow financially distressed cooperatives to defer principal and interest payments on REA loans. If a modification of the terms of a debt instrument occurs, it must be determined whether the modification is significantly material to constitute a deemed exchange of the debt instrument for a new debt instrument (with the modified terms) under IRC 1001. In general, a significant deferral of interest or principal payments constitutes a deemed exchange under IRC 1001.

(1) Original Issue Discount. If an IRC 1001 exchange occurs, original issue discount (OID) is created on the new debt equal to the difference between the IRC 1274 issue price of the new debt and the stated redemption price at maturity (SRPM) of the new debt. The SRPM of the new debt is equal to the stated principal (face) amount of the new debt plus any interest that is not paid on a current basis. The IRC 1274 issue price of the new debt is equal to the lesser of: (A) the face amount of the new debt and (B) the present value, as of the date of the modification, of all payments of principal and interest due on the new debt, calculated using a discount rate equal to the Applicable Federal Rate. OID on the new debt is amortized by the cooperative over the term of the new debt on a constant yield basis.

(2) Cancellation of Indebtedness Income. In addition, the cooperative recognizes cancellation of indebtedness income on the exchange to the extent the face value of the old (unmodified) debt (plus any unamortized premium and less any unamortized discount) exceeds the IRC 1274 issue price of the new debt. Discharge of indebtedness income will generally occur if the old debt bears an interest rate that is below the Applicable Federal Rate. Any discharge of indebtedness income is (nonmember) gross income in the taxable year realized. See also (12)22.3(4)(c) on discharge of indebtedness income on prepayment of

certain REA loans at a discount. For additional information on modification of debt instruments, contact the Office of the Assistant Chief Counsel (Financial Institutions & Products).

(h) Gains and Losses from Sale of IRC 1221, 1231, 1245 and 1250 Property. See *The Mountain Water Co. of LaCrescenta v. Commissioner*, 35 T.C. 418 (1960), *acq. on other issues*, 1961-2 C.B. 5; *Cate Ditch Co. v. United States*, 194 F. Supp. 688 (S.D. Cal. 1961); Rev. Rul. 65-99, 1965-1 C.B. 242 (gain on sale of office building). *Cf.* Rev. Rul. 74-84, 1974-1 C.B. 244.

(4) Exclusions from the 85 Percent Test. The following amounts are excluded in computing the 85 percent test in Treas. Reg. § 1.501(c)(12)-1:

(a) Sale of Excess Fuel at Cost. Sale of excess fuel, (an inventoriable item) at cost, yields no gross income and, therefore, does not enter into the 85 percent test. Rev. Rul. 80-86, 1980-1 C.B. 118.

(b) Qualified Pole Rentals. Qualified pole rentals are rental income from the right to use any pole (or other structure that supports wires) that the cooperative uses to provide electricity to members. IRC 501(c)(12)(C)(i), (D).

(c) Discharge of Indebtedness Income on Prepayment of Certain REA Loans at a Discount. Gross income includes income from discharge of indebtedness. IRC 61(a)(12). The amount of indebtedness discharged equals the face amount of the debt (adjusted for any unamortized premium or discount) minus any consideration given by the taxpayer to effect the discharge. Discount income is nonmember income. The effect on the 85 percent test of loan prepayment at a discount, however, depends on when the loans are prepaid:

(1) Prepayments Between 1986 and 1989. Cooperatives were permitted to prepay at a discount certain REA loans made pursuant to sections 306A, 306B or 311 of the Rural Electrification Act of 1936 (as in effect on January 1, 1987) (7 U.S.C. §§ 936a, 936b, 940a). OBRA 1986, Pub. L. No. 99-509 § 1101(a) and Continuing Appropriations for F/Y 1987, Pub. L. No. 99-591 § 101(m) (Title IV § 623); Food, Agriculture, Conservation and Trade

Act of 1990, Pub. L. No. 101-624 § 2387. However, TAMRA 1988 excludes from the 85 percent test discharge of indebtedness income realized from prepayment of loans from REA or any loans made or guaranteed by the United States (or any of its agencies or instrumentalities) after December 31, 1986 and before January 1, 1990. TAMRA 1988, Pub. L. No. 100-647 § 6203; S. Rep. No. 445, 100th Cong., 2d Sess. 411, *reprinted in* 1988 U.S.C.C.A.N. 4918-9; H. Conf. Rep. No. 1104, 100th Cong., 2d Sess., 211, 1988-3 C.B. 211.

(2) Prepayments in 1990 and Later Years. Cooperatives may again prepay certain REA loans at a discounted present value. REA Improvement Act of 1992, Pub. L. No. 102-428 § 2; 7 C.F.R. § 1786 (59 Fed. Reg. 13616 (Mar. 22, 1994)). Loan discounts probably range between 10 and 15 percent. Any discharge of indebtedness income realized from loan prepayments on or after January 1, 1990 is non-member income in computing the 85 percent test.

(5) Consequences of Failing the 85 Percent Test. If, in any taxable year, a cooperative fails the 85 percent test, it is a nonexempt cooperative and must file Form 1120. IRC 501(c)(4) does not apply. Rev. Rul. 57-494, 1957-2 C.B. 315, *nonacq. in United States v. Pickwick Elec. Mem. Corp.*, 158 F.2d 272 (6th Cir. 1946).

(12)22.4 Unrelated Business Taxable Income

(1) For an overview of IRC 511-514, see *Exempt Organizations Handbook*, "Taxation of Unrelated Business Taxable Income," ch. (35)00-(41)00 and annual Technical Instruction Programs. The following additional issues may also arise in examination of cooperatives:

(2) Sales and service of appliances for nonmembers who purchase no electricity from the cooperative are unrelated trade or business. Treas. Reg. §§ 1.501(c)(12)-1(a); 1.513-1(a), (d).

(3) Income from debt-financed investments may be taxable under IRC 514(a) (e.g., arbitrage investments of REA loan funds). *Southwest Tex. Elec. Coop. v. Commissioner*, T.C. Memo. 1994-363 (1994); *Kern County Elec. Pension Fund v. Commissioner*, 96

T.C. 845 (1991), *aff'd* 988 F.2d 120 (9th Cir. 1993);

(4) IRC 1245 and 1250 depreciation recapture rules override IRC 512(b)(5). Treas. Reg. §§ 1.1245-6(b); 1.1250-1(c)(2);

(5) Payments from affiliated organizations or subsidiaries may be taxable under IRC 512(b)(13); and

(6) Qualified pole rentals are not income from unrelated trade or business. IRC 513(g).

(12)22.5 Other Code Sections Applicable in Examinations of Cooperatives

(1) IRC 446 and 481. Method of accounting issues and changes in methods of accounting arise in many examinations of cooperatives. There are numerous differences between book and tax. See *Utilities Handbook* §§ 320-322, 426, 430-438, 445 and discussion below. Note that a method of accounting (e.g., depreciation and capitalization) elected on Form 990 may not be changed without the consent of the Commissioner, irrespective of whether the cooperative files Form 990 or Form 1120 in a subsequent year. Treas. Reg. § 1.446-1(e).

(2) IRC 266. Cooperatives may elect to capitalize certain taxes and carrying charges (including interest) into the adjusted basis of property. An election may affect the amount of gain on a cooperative's sale of utility plant, affecting the 85 percent test. On elections and their consequences, see Treas. Reg. § 1.266-1; Rev. Rul. 90-38, 1990-1 C.B. 57.

(3) IRC 118.

(a) Contributions to the capital of a cooperative are not gross income to the cooperative. But contributions in aid of construction or any other contribution as a customer or potential customer are not contributions to capital. IRC 118(a), (b); Treas. Reg. § 1.118-1; *United States v. Chicago, B. & O. R. Co.*, 412 U.S. 401 (1973), 1973-2 C.B. 428; *Utilities Handbook* § 434.

(b) For taxable years beginning after December 31, 1985, IRC 118(b) was repealed. Consequently, contributions that a cooperative receives after December 31, 1985 to provide or encourage providing services or for the benefit of the contributor must be reported as income by the cooperative.

(4) IRC 269. If any person(s) acquire, directly or indirectly, control over a corporation and the principal purpose of the acquisition is to evade or avoid federal income tax by securing the benefit of a deduction, credit or other allowance, which the acquiring person(s) or the controlled corporation would not otherwise enjoy, then the Service may disallow the deduction, credit or allowance. IRC 269(a); Treas. Reg. § 1.269-1. "Allowance" is defined very broadly. Treas. Reg. § 1.269-1(a). IRC 269 may apply to cooperatives and/or their subsidiaries (e.g., in applying the 85 percent test, if a subsidiary is used as a conduit for sales to nonmembers).

(5) IRC 483 and 7872. Imputed interest rules on deferred payments or below-market loans receivable (e.g., installment sales) may affect the computation of interest income, the 85 percent test or unrelated trade or business taxable income.

(6) IRC 103. [Reserved].

(12)22.6 Deferred Compensation and Retirement Benefits

(1) Cooperatives may provide several types of deferred compensation or retirement benefits for their employees. These include qualified plans, and eligible and ineligible deferred compensation plans under IRC 457. For additional information on deferred compensation plans under IRC 457 contact the Office of Associate Chief Counsel (Employee Benefits & Exempt Organizations).

(2) Qualified Plans. A qualified plan is a funded, tax exempt plan. The employer makes contributions which are generally held in trust. In some cases, employees may also contribute. There is a wide variety of qualified plan types, including pension and profit-sharing plans. They are subject to numerous qualification requirements under IRC 401. A plan may (but is not required to) obtain a determination letter from a key district office. This letter would constitute a ruling that the plan met the qualification requirements in form. It would not assure that the plan met all of the requirements for qualification in operation.

(a) Qualified Plan Requirements. Qualified plans are subject to numerous and complex requirements governing discrimination in favor of highly compensated employees, lim-

itations on contributions and benefits, coverage of employees, participation levels, vesting, funding, portability, holding of investments, and other requirements.

(b) IRC 401(k) Plans. A qualified plan may include a "qualified cash or deferred arrangement," often called a "section 401(k) plan." A cooperative, unlike other tax-exempt organizations and state and local government entities, is allowed to maintain a qualified cash or deferred arrangement. See IRC 401(k)(4)(B) (last sentence). Under a qualified cash or deferred arrangement, an employee may choose whether to receive part of his or her compensation in cash or to have it contributed to the plan. The election most commonly takes the form of a salary reduction arrangement. The contributions are called "elective deferrals," and are limited to a dollar amount (\$9,240 in 1994), which is adjusted annually for changes in the cost of living. Elective deferrals are subject to a special nondiscrimination test called the actual deferral percentage test ("ADP test"), in which the average deferral percentage of highly compensated employees is compared to that of non-highly compensated employees. The plan is also subject to all of the requirements that generally apply to qualified plans, and to some special requirements.

(3) Nonqualified Plans. Any other plans, agreements, or arrangements deferring the receipt of compensation to some future date or event such as retirement or separation from service are nonqualified plans. There is a wide variety of nonqualified deferred compensation plans. These arrangements may be elective (including salary reduction) plans or nonelective plans. They may be defined benefit or defined contribution plans. They may be unfunded plans where the participants have only a contractual promise from the employer that future payments will be made and any assets held to make payments are reachable by general creditors of the employer or they may be funded plans where cash or other assets are transferred to a trust or other third party, such as an insurance company, for payment to participants at a later date.

(a) Unfunded Plans. The tax consequences of unfunded plans are

contained in IRC 457 and the regulations thereunder. An unfunded plan of a state or local government or an agency or instrumentality thereof, or of any other tax exempt organization is either (A) an eligible deferred compensation plan, or (B) an ineligible deferred compensation plan. The tax consequences differ significantly.

(1) Eligible Plans. Under IRC 457(a), participants in an eligible plan, defined in IRC 457(b), are taxed on deferred amounts when those amounts are paid or made available to plan participants following separation from service or in the event of a distribution for an unforeseeable emergency.

(2) Ineligible Plans. If the plan is not an eligible plan, plan participants are taxed when amounts are deferred unless there is a substantial risk of forfeiture. A “substantial risk of forfeiture” is defined by IRC 457(f)(3)(B) as existing if a “person’s rights to [the] compensation are conditioned upon the future performance of substantial services by any individual.”

(3) Participants. All employees of a state or local government or an agency or instrumentality thereof may participate in an IRC 457 plan. Only a select group of management or highly compensated employees, however, may participate in an IRC 457 plan maintained by a tax exempt employer. (This is necessary to maintain the plan’s exemption from the funding requirements of ERISA.)

(4) Maximum Deferrals. Each participant in an eligible IRC 457 plan may defer up to the lesser of \$7,500, or 33⅓ percent of includible compensation (generally meaning taxable compensation) in a taxable year. This limit applies to both elective and nonelective deferred compensation. It is not indexed. Under a catch-up provision, a participant may defer up to \$15,000 in each of the last three taxable years before he or she reaches normal retirement age, but the increase over the normal limit is available only to the extent of unused portions of the limitations for previous years. All eligible IRC 457 plans of an employer are aggregated, and no individual may defer a total of more than \$7,500 (\$15,000 if the catch-up provision applies) in a taxable year

(even under plans of more than one employer). The same limits apply to a nonqualified defined benefit plan. This is a plan that specifies the benefit that a participant will receive in the future rather than the amount that will be added to his or her account each year. A defined benefit plan often fixes a benefit based on factors such as compensation and length of service, and usually provides a benefit in the form of an annuity or payments over a number of years. Benefits under a defined benefit plan do not depend on the performance of any investments acquired by the employer. Applying the limits to a nonqualified defined benefit plan is more difficult than applying them to a defined contribution plan. The benefit subject to the limit in any year is the present value of the increase in the participant’s accrued benefit during that year. This present value will usually be different for each participant, and will often change from year to year. Consult an actuary (in Employee Plans) for assistance in determining the present values. It is important to remember that the limit applies to increases in the participant’s accrued benefit on a year-by-year basis. A plan would not satisfy this requirement if it merely applied an aggregate limit (based on all of the participant’s service) to the total accrued benefit. If an employee participates in both a nonqualified defined benefit plan and a nonqualified defined contribution plan, the annual limit applies to the sum of (A) the present value of the increase in the accrued benefit under the defined benefit plan, and (B) the amount deferred under the defined contribution plan.

(5) Coordination of Deferrals. IRC 457(c) requires that deferrals under an eligible IRC 457 plan be coordinated with certain other plans such as IRC 401(k) plans. This means that elective deferrals by the employee under an IRC 401(k) plan are subtracted from the \$7,500 (or \$15,000 in a catch-up year) limit. As a result, an employee who elects any deferrals under an IRC 401(k) plan will only be able to defer \$7,500 (or \$15,000 in a catch-up year) under the combination of IRC 401(k) and 457 plans, even though a higher limit might be available under the IRC 401(k) plan alone.

(6) Plan Administration Consistent with IRC 457(b). A plan that is consistent with IRC 457(b), but that is administered in a manner that is inconsistent with the requirements of IRC 457(b), may lose its status as an eligible plan. If the employer is a state or local government or an agency or instrumentality thereof, the plan does not become ineligible until the beginning of the first plan year beginning more than 180 days after notification by the Secretary of the Treasury of the inconsistent administration. If the inconsistency is corrected before the first day of that plan year, the plan remains an eligible plan. This grace period for correcting administrative defects does not apply to an employer that is a tax exempt organization other than a government.

(b) Funded, Nonqualified Plans. A plan that is funded (*e.g.*, through a trust, annuity contracts, or other vehicle insulating the assets from the general creditors of the employer) but is not a qualified plan is not governed by either IRC 401 or IRC 457. The tax consequences of funded, nonqualified plans are contained in IRC 402(b), 403(c) and 83, which require that a participant recognize income when amounts are paid to a trust or insurance company unless there is a substantial risk of forfeiture as defined in IRC 83(c)(1) and the participant’s interest is nontransferable.

(4) Tax-Sheltered Annuity. An IRC 403(b) annuity, often called a “tax-sheltered annuity,” is an annuity contract that may be purchased by an IRC 501(c)(3) organization or educational institution of a state or local government for its employees. Custodial accounts for registered investment company stock (mutual funds) may also be treated as annuity contracts for purposes of IRC 403(b), if they meet certain requirements. Since a cooperative is neither an IRC 501(c)(3) organization nor an educational institution of a state or local government, it cannot maintain an IRC 403(b) annuity plan. Any plan of a cooperative purporting to be an IRC 403(b) plan would probably consist of either nonqualified annuity contracts or taxable custodial accounts or trusts, and would be a funded, nonqualified plan. Contact an Employee Plans specialist if you encounter such a plan.

(12)22.7 Employee Benefits

(1) Cafeteria Plans.

(a) Under present law, compensation generally is includible in gross income when actually or constructively received. An amount is constructively received by an individual if it is made available to the individual or the individual has an election to receive such amount. Under one exception to the general principle of constructive receipt, no amount is included in the gross income of a participant in a cafeteria plan described in IRC 125 solely because, under the plan, the participant may elect among cash and certain employer-provided qualified benefits.

(1) Qualified Benefits. In general, a qualified benefit is a benefit that is excludable from an employee's gross income by reason of a specific provision of the Code. Thus, employer-provided accident or health coverage, group-term life insurance coverage (whether or not subject to tax by reason of being in excess of the dollar limit on the exclusion for such insurance) and benefits under dependent care assistance programs may be provided through a cafeteria plan. However, a cafeteria plan may not provide qualified scholarships or tuition reduction (IRC 117), educational assistance (IRC 127), or miscellaneous employer-provided fringe benefits (IRC 132). In addition, a cafeteria plan may not offer deferred compensation except through a qualified cash or deferred arrangement (IRC 401(k)).

(2) Cash or Qualified Benefits. Employer contributions to the cafeteria plan are usually made pursuant to salary reduction agreements between the employer and the employee in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits. A salary reduction agreement is sufficient to satisfy the "cash" requirement of a cafeteria plan.

(3) Plan Requirements. A cafeteria plan must be in writing, must include only employees (including former employees) as participants and must satisfy certain non-discrimination requirements. An employer that maintains a cafeteria

plan is required to file an annual return relating to such plan.

(b) Employment Taxes. The cafeteria plan exception from the principle of constructive receipt generally also applies for employment tax (FICA and FUTA) purposes.

(2) Voluntary Employees' Benefit Associations (VEBAs). If the cooperative maintains a VEBA or taxable trust for payment of welfare benefits, it may be appropriate to include the VEBA in the examination. See *Exempt Organizations Handbook*, "Voluntary Employees' Benefit Associations," ch. 900.

(12)22.8 Employment Taxes

(1) General Considerations. Taxable compensation paid to employees may not be properly reflected on Forms 990, employment tax returns, or Forms W-2. Determine whether payments to individuals who are not employees are properly reported on Forms 1099. Determine whether the cooperative has properly classified its workers. Be alert to efforts to treat employees as independent contractors. For a list of the 20 common law factors indicating an employment relationship, see Rev. Rul. 87-41, 1987-1 C.B. 296. In any questionable situation, determine whether a Form SS-8 has been filed by the cooperative or the worker. See IRM 7(10)(16)4.8.

(2) Section 530. Be sure to raise employment tax classification issues. Under section 530 of the Revenue Act of 1978, a cooperative may be entitled to relief from employment taxes with respect to a particular worker if three requirements are satisfied: the cooperative must have filed all federal tax returns (including information returns) required to be filed on a basis consistent with treating the worker as not being an employee; the cooperative must not have treated any worker holding a substantially similar position as an employee for employment tax purposes after December 31, 1977, and the cooperative must have a "reasonable basis" for not treating the worker as an employee. Reasonable basis may exist if the cooperative's treatment of workers as independent contractors was in "reasonable reliance" on a past examination of the cooperative in which there was no assessment attributable to the treatment for employment tax purposes of individuals holding

positions substantially similar to the position held by the worker in question. The cooperative may be entitled to rely on a prior examination whether or not it was an employment tax examination. See Rev. Proc. 85-18, 1985-1 C.B. 518.

(3) Meal Allowances. See ISP Coordinated Issue: Meal Allowances (1994).

(4) Fringe Benefits.

(a) Overview. A fringe benefit is any property or service (or cash, under certain circumstances) that an employee receives from the cooperative in lieu of or in addition to regular taxable wages. If a benefit is not specifically excluded from gross income by the Code (e.g., IRC 79, 105, 106, 107, 117(d), 119, 127, 129, and 132), its value must be treated as compensation and reported as wages in Box 1 of the employee's Form W-2. See IRM 7(10)(16)9.81. In 1989, the Service issued final regulations under IRC 61 and 132, setting forth specific rules for valuing fringe benefits and for determining the applicability of the exclusions in IRC 132 (no-additional-cost services, qualified employee discounts, working condition fringes and *de minimis* fringes). Fringe benefits can take many forms. See the User's Guide to "More Basics: The Basics of Fringe Benefits", which was produced by the Office of Chief Counsel, IRS Technical TV (January 1994).

(b) Examination of Fringe Benefits. Perform the following procedures:

(1) Review a sampling or list of Forms 1099 and W-2 issued by the cooperative. Compare them with a sample of expense entries to determine if the cooperative is consistently and properly issuing Forms 1099 and W-2;

(2) If the cooperative has a plan whereby employees receive reduced rates for insurance or other services provided by suppliers to the cooperative, determine the extent of the cooperative's involvement and whether the reduced rates constitute a fringe benefit; and

(3) Determine whether the cooperative provides free or discounted parking to its employees. Under IRC 132(f), the fair market value of "qualified parking" in excess of the statutory exclusion is includable in

an employee's gross income and must be reported as wages in Box 1 of Form W-2. See Notice 94-3, 1994-1 C.B. 327, for more information.

(12)22.9 Excise Taxes

An excise tax is imposed on sales of coal taken from mines located in the United States and on certain fuels. These are issues which may arise in the examination of G&Ts. IRC 4121, 4081. The excise taxes on certain large vehicles and the highway use tax may arise in examinations of all cooperatives. IRC 4051, 4481. See generally, *Utilities Handbook* § 448; IRM 4700.

(12)22(10) State and Federal Regulation of Electric Cooperatives

(1) State Public Utility Commissions (PUCs). In approximately 21 states, the state public utility commission (PUC) regulates rates charged by electric cooperatives. These and other states may also restrict or regulate the non-utility investments of electric cooperatives (e.g., no loans from a cooperative to any affiliated companies without PUC approval). To ascertain if the cooperative is regulated by a PUC, see *Utility Regulatory Policy in the United States and Canada*, NARUC (1992). In these states, the cooperative's filings with the PUC and the PUC's orders may reveal information useful to the examiner (e.g., changes in billing procedures).

(2) Federal Energy Regulatory Commission (FERC). FERC regulates the rates, terms and condition of wholesale electric power sales and transmission services. Certain G&Ts file annual reports with FERC. (FERC Form 1). These reports are public information.

(3) Rural Electrification Administration (REA).

(a) Virtually all electric cooperatives finance their utility plant through loans from or guaranteed by REA. (Note: Although REA's name has been changed to Rural Utilities Service (RUS), these guidelines refer to "REA." Pub. L. No. 103-354 § 232 (1994)). G&Ts generally borrow from the Federal Financing Bank (FFB) or from private lenders with REA guaranteeing the loans.

(b) Loan Terms. G&Ts' interest rate equals Treasury's cost of funds

plus 1/8 percent. G&Ts also obtain financing through pollution control bonds. Distribution cooperatives generally obtain insured loans from REA. REA finances 70-90 percent of the loan amount, with other lenders (e.g., National Utilities Cooperative Finance Corporation (CFC)) financing the balance. The interest rate is a blended rate of 5 percent on the REA portion and market rate on the balance. The interest rate on other loans varies. 7 C.F.R. § 1714.2 *et seq.*

(c) Loan Origination and Documentation. Cooperatives submit loan proposals requesting REA financing for constructing new utility plant or replacing existing plant. REA lends only for construction of capital assets, not for maintenance or repairs. As a result, cooperatives generally have an economic incentive to classify disbursements as capital expenditures (as opposed to current expenses). Upon approval of the loan proposal, the cooperative executes a promissory note in favor of REA and executes the REA Mortgage. The cooperative deposits REA loan proceeds in a special trustee account and expends its own funds to construct the new plant. After REA reviews and approves the cooperative's documentation of construction expenditures, the cooperative may then withdraw the approved amount from the trustee account and deposit the funds in its own cash accounts.

(d) REA Oversight. To ensure repayment of loans, REA requires cooperatives to follow its Uniform System of Accounts and audit procedures (see below). REA holds a first mortgage on all the cooperative's property. The REA Mortgage requires the cooperative to submit detailed annual financial reports to REA including certified audits performed by independent certified public accountants (CPAs) and other reports. All reports are public information. If cooperatives do not comply with these (and other) requirements, REA may declare the loan in default, suspend all future lending to the cooperative and exercise other remedies reserved under the REA Mortgage. To insure that loan funds are used properly, REA field accountants review cooperatives' financial records, reports and financial

statements prepared by cooperatives' CPAs at least once every three years. These REA Field Reports are public documents.

(12)22(11) REA's Uniform System of Accounts

(1) Overview. REA requires detailed financial information and reporting on cooperatives' activities (e.g., corporate structure, reorganizations and acquisitions, investments in affiliated companies, extraordinary gains and losses). Cooperatives must keep detailed books of account using REA's Uniform System of Accounts (USoA), published at 7 C.F.R. § 1767 (58 Fed.Reg. 59822 (1993)), clarifying and modifying the prior USoA. The USoA is based on FERC's accounting system, with some modifications. Cooperatives must also follow REA Accounting Principles (Accounting Principles). 7 C.F.R. § 1767.41. Accounting Principles mandate the entries to book particular transactions and aid in understanding the proper accounting treatment of items. REA also publishes Accounting Interpretations on the USoA. Because many accounts and account numbers in the USoA from prior years remain unchanged, these examination guidelines (citing to the 1994 USoA) can generally be used to examine taxable years beginning before 1994.

(2) Recordkeeping and Accounting Requirements. Cooperatives must keep books of account and all supporting books, records, minute books, memoranda, etc. to support all entries in books of account. 7 C.F.R. § 1767.15. Cooperatives must use the accrual method of accounting (as defined in Generally Accepted Accounting Principles (GAAP)). 7 C.F.R. § 1767.15(k). Separate accounting records must be maintained for each power plant and for any other utility department (e.g., gas or water). 7 C.F.R. § 1767.15(l), (m).

(3) The USoA contains the following Accounts:

(a) Balance Sheet Accounts:	
100 - 199	Assets and Other Debits
200 - 299	Liabilities and Other Credits
300 - 399	Plant Accounts
433, 436 - 439	Retained Earnings Accounts

(b) Income and Expense Accounts:

400 – 432;	Income Accounts
434 – 435	(Net Income)
440 – 459	Revenue Accounts
500 – 599	Production, Transmission and Distribution Expenses
900 – 949	Customer Accounts, Customer Service and Informational, Sales and General and Administrative Expenses

(c) Note on Accounts. Most USoA nonbalance sheet accounts are paired Revenue Accounts and Expense Accounts. “Income Accounts” (generally, the less significant accounts), combine revenue and expense in a single account. Certain nonbalance sheet accounts show revenue and expense for transactions between different departments within the cooperative. As noted below, timing differences and permanent differences abound between REA accounting and income tax accounting. For these and other reasons, in conducting the examination, it may be necessary adjust the amounts shown on the financial statements.

(d) Exhibits. On closing operating and nonoperating revenue and expense accounts into patronage capital accounts at the end of the fiscal year, see Exhibit 12(20)–1, “Summary of Accounts Used in Connection with Recording Patronage Capital.” Exhibit 12(20)–2, “Applying the 85 Percent Test: Analysis of REA Uniform System of Accounts (Selected Revenue, Income, Expense and Balance Sheet Accounts)” illustrates the income tax treatment of certain USoA Accounts.

(e) There is insufficient space in these guidelines to explore all aspects of the USoA, GAAP, Generally Accepted Government Auditing Standards (GAGAS) relevant to examination of cooperatives. Review particular provisions relevant to the examination. Examiners may contact REA’s Technical Accounting and Auditing Staff with questions at (202) 720-5227.

(4) Entities Covered by Financial Statements. A cooperative’s financial statements must comply with FAS No. 94, “Consolidation of All Majority-

Owned Subsidiaries.” If the cooperative owns a majority interest in a subsidiary (as defined (12)22(21)), the cooperative must prepare consolidated financial statements including the subsidiary, together with supplementary schedules presenting a balance sheet and income statement for each subsidiary. REA Forms 7 and 12 must be prepared on an unconsolidated basis. Accounting Principle 404, Consolidated Financial Statements. The REA regulations contain sample financial statements (with accountants’ notes) for an electric cooperative. 7 C.F.R. §§ 1789.38; 1773 Appendix B, Exhibit 7.

(5) REA Regulations on CPAs’ Audits of REA Borrowers. The CPAs must prepare and submit the following annual reports to REA:

(a) Auditor’s Report (on the cooperative’s financial statements, including accountants’ notes and statements of cash flows);

(b) Report on Compliance with Applicable Laws and Regulations (as required by SAS No. 63, “Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance” and GAGAS);

(c) Report on Internal Controls; and

(d) Management Letter (including disclosure of material transactions with related parties (e.g., officers and directors) as required by SFAS No. 57, “Related Party Disclosures”).

7 C.F.R. §§ 1773.30–1773.34.

These reports and the management letter are public documents.

(e) See 7 C.F.R. § 1773 Appendix A for sample financial statements, auditor’s report, compliance report and report on internal controls. See 7 C.F.R. § 1773, Appendix C for a sample management letter.

(12)22(12) General Considerations in Examinations

(1) Coordinated Examinations. Examinations of cooperatives may use the coordinated examination procedures, where appropriate. See IRM 7(10)-(18)0. If an examination is of limited scope, the coordinated examination procedures may be followed to the extent they are useful, although the

examination has not been approved as a CEP case.

(2) Assistance from Other Functions. If, in connection with the examination of a cooperative, the case manager and the examiner believe that it is also necessary to examine an entity not under the jurisdiction of EP/EO Examination (e.g., a joint venture operating a power generating plant), they should request assistance from the function responsible for examining that entity.

(3) Employment Taxes. Follow the package audit procedures in IRM 7(10)44.5 and, as appropriate, the employment tax procedures in IRM 7(10)(16)0. For general instructions on handling employment tax examinations and assessments of additional tax on fringe benefits, see IRM 7(10)(16)9.81. See generally, *Utilities Handbook* §§ 447, 44(14).

(4) Compliance Checks. *Utilities Handbook* § 460 outlines compliance checks on certain issues (e.g., unlawful activities). Consider whether performing any of these procedures is appropriate.

(12)22(13) Initial Contact Items

(1) The examiner should consult the following for assistance in planning and conducting the examination:

(a) State Public Utility Commissions. If one or more PUCs regulate the cooperative, contact the PUC(s) concerning the cooperative’s filings and PUC orders.

(b) Federal Energy Regulatory Commission. Contact the Office of Chief Accountant at (202) 219-2600.

(c) Rural Electrification Administration. Contact the Director of Borrower Accounting at (202) 720-9450.

See *Utilities Handbook* § 240.

(12)22(14) Requesting the Assistance of Specialists

(1) Utilities Industry Specialist/Media/Communications Industry Specialist (cable television and direct TV). The Industry Specialists can assist the examiner with the following:

(a) identifying unique industry issues and Service position;

(b) giving insight into the economic conditions of the industry;

(c) describing accounting and business practices; and

(d) suggesting examination procedures and computer programs that may have potential application.

Utilities Handbook § 152; IRM 42(10)(14)0.

(2) VEBA (Voluntary Employees' Beneficiary Association) Industry Specialist. The Industry Specialist can assist with examination of VEBAs.

(3) Computer Audit Specialist. If the services of a computer audit specialist are necessary, obtain a description of the cooperative's hardware, software (including accounting software) and formats of files and records.

(4) Engineer. All cooperative returns with assets of \$10 million or over must be referred for engineering action. IRM 42(16)0, 7(10)25.1. This mandated referral overrides IRM 7(10)25.1(4). In examination of exempt and nonexempt cooperatives, the engineer is a valuable resource (e.g., tax exempt bonds, construction techniques, machinery and building design, repairs, depreciation, depletion and valuation of assets). The engineer should be involved in the early planning stages of the examination. See generally, *Utilities Handbook* § 154.

(5) Excise Tax Specialist. Examinations of cooperatives (particularly G&Ts) often raise excise tax issues which may require the use of an Excise Tax Specialist. *Utilities Handbook* §§ 158, 448; IRM 4700.

(6) Employee Plans Specialist. See IRM 45(10)0 for employee plans examinations.

(7) Tax Exempt Bonds. [Reserved]. See 7(10)7(11).4.

(12)22(15) Initial Document Requests

(1) Obtain and review the documents listed below to gain a basic understanding of the cooperative's activities, capital structure and related organizations:

(a) Documents to be Requested from All Electric Cooperatives:

(1) Articles of Incorporation (and all amendments);

(2) bylaws (and all amendments);

(3) a list of all the names and addresses of subsidiaries and associated companies (as defined in (12)22(21));

(4) names and addresses of all directors, trustees and officers of the cooperative and of all subsidiaries and associated companies;

(5) minutes of meetings of board of directors and of all board committees;

(6) annual reports, financial statements (including statement of cash flows and accountants' notes) and tax returns for all subsidiaries and associated companies (as defined in (12)22(21));

(7) REA Forms 7 Financial and Statistical Report, Operating Report — Financial, Form 12;

(8) REA Field Reports on the cooperative (from REA field accountants or engineers);

(9) any debt restructuring plan entered into between the cooperative and REA;

(10) Methods and Procedures Manual (procedures to record transactions);

(11) a chart of accounts correlating general ledger accounts to USoA Accounts;

(12) the cooperative's 85 percent test worksheets;

(13) the cooperative's policy book on patronage capital and patronage dividends;

(14) an analysis of income and expense;

(15) an analysis of deferred credits and deferred debits with supporting documentation (this analysis is required in 7 C.F.R. § 1773.34(h)).

(16) all reports filed with REA (including but not limited to: REA Forms 7, 12; audited financial statements (including statement of cash flows and accountants' notes)); auditor's report, compliance report, report on internal controls and management letter;

(17) all reports and other filings with PUCs and PUC orders (if applicable);

(18) all agreements between the cooperative and any subsidiary or associated company;

(19) qualified employee retirement plans: the official plan and trust documents, any determination letters issued to qualified plans, records of employer and employee contributions, account balances or accrued benefits and employee compensation;

(20) nonqualified deferred compensation plans: employee benefit plans and related documents (e.g., trusts, insurance contracts, private letter rulings), records of employer and employee contributions and account balances or accrued benefits;

(21) all other employee benefit plans: including accident and health plans, cafeteria plans and VEBAs, related documents (including any trust instruments); See *Exempt Organizations Handbook*, "Voluntary Employees' Benefit Associations," ch. 900;

(22) all arrangements for compensation of directors (including qualified and nonqualified deferred compensation plans). See also *Utilities Handbook* § 132; and

(23) a schedule of all funded reserves (including any trusts or VEBAs for payment of welfare benefits or postretirement benefits).

(2) Documents to be Requested from G&T Cooperatives:

(a) a list of the names and addresses of all members;

(b) all reports filed with FERC (including complete FERC Forms 1) (If the G&T jointly operates any generating station with another cooperative, public utility or government agency, also request complete FERC reports filed by the other entity or entities);

(c) all power delivery agreements (or power supply agreements) in effect during the years under examination;

(d) all power exchange or power pooling agreements;

(e) all power rate schedules in effect during the years under examination;

(f) representative sample invoices for excess capacity sales and for off-peak sales;

(g) for any jointly operated generating station (as defined above): all operating agreements, station agreements, load management agreement and all other agreements concerning a jointly operated station, income and expense analysis. In some circumstances, the examiner may also need to request all documents (including agreements and correspondence) concerning acquisition, construction and financing of such stations;

(h) Securities and Exchange Commission Forms 10-K filed by the cooperative (if applicable);

(i) the method used to compute patronage dividends;

(j) workpapers used to support claimed patronage dividends;

(k) notification letters to all members on allocations of patronage dividends; and

(l) tax exempt bonds. Contact Headquarters; Chief, Exempt Organizations Technical Branch 4.

(3) Documents to be Requested from Distribution Cooperatives:

Newsletters and other communications to members.

(12)22(16) Examination of Financial Statements and Reports to Regulatory Agencies

(1) Methods of Accounting. As noted, cooperatives must use the accrual method (as defined in GAAP, with modifications) for REA reporting. 7 C.F.R. § 1767.15(k). Although the basic principles are the same, the accrual methods for REA accounting and income tax accounting diverge. When this occurs, income tax accounting rules control. *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979); Treas. Reg. § 1.446(e)-1; Rev. Rul. 90-38, 1990-1 C.B. 57; Rev. Proc. 92-20, 1992-1 C.B. 685. There are many differences between REA accounting and income tax accounting affecting the timing of income and expense, gain and loss and raising issues under IRC 61, 118, 451, 1001, 1231, IRC 446 and 481 for changes in methods of accounting. This may affect the 85 percent test in IRC 501(c)(12) and also IRC 461 and 512. *Utilities Handbook* §§ 320-322, 430-438.

(2) IRC 451(f). Accrual basis electric utilities must recognize income from sale of electricity to customers not later than the taxable year in which the electricity is provided. Utilities may not accrue income relying on when they read customers' meters or when they bill customers. IRC 451(f), effective for taxable years beginning after December 31, 1986. On IRC 481(a) adjustments resulting from IRC 451(f), see Pub. L. Nos. 99-514 § 821(b)(2), (3) and 100-647 § 1008(h). S. Rep. No. 313, 99th Cong., 2d Sess., 1986-3 C.B. (Vol. 3) 120-121; H. Conf. Rep. No. 841, 99th Cong., 2d Sess., 1986-3 C.B. (Vol. 4) II-322-324. For prior law (cycle billing vs. budget billing), see Rev. Rul. 72-114, 1972-1 C.B.

124; *Utilities Handbook* § 432. Note that Account 173, Accrued Utility Revenue, unlike IRC 451(f), allows cooperatives to accrue (or not accrue) estimated revenue for electricity sold but not billed as of the end of the taxable year. As a result, adjustments to the cooperative's income may be necessary.

(3) Timing Differences Between REA Accounting and Income Tax Accounting.

(a) Distribution cooperatives generally use cycle billing or budget billing. Cycle billing is based on monthly meter reading and billing cycle. Budget billing is based on an annual projected budget; customers are billed a level amount monthly with an annual adjustment reflecting actual electricity consumption. Account 173, Accrued Utility Revenue. On billing methods, see Rev. Rul. 72-114, 1972-1 C.B. 124; *Utilities Handbook* § 432. Ascertain whether the cooperative accrues income consistently and in accord with IRC 451(f).

(b) Accounts 200.1, Memberships Issued; 252, Customer Advances for Construction or 208, Donated Capital may raise issues under the 85 percent test and IRC 118, 446 or 481. See Rev. Rul. 75-557, 1975-2 C.B. 33, *clarified* in Rev. Rul. 76-61, 1976-1 C.B. 12; *Utilities Handbook* §§ 434, 435.

(c) Amounts in Account 235, Customer Deposits typically represent a security deposit for electricity. *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203 (1990); Rev. Proc. 91-31, 1991-1 C.B. 566; Rev. Rul. 72-519, 1972-2 C.B. 32; *Utilities Handbook* § 435.

(d) The following Accounts may also affect the timing of income, expense, gain or loss: Account 229, Accumulated Provision for Rate Refunds; Account 449.1, Provision for Rate Refunds. See also, discussion of transfer of utility plant and other property.

(12)22(17) Analysis of Financial Statements and Accountants' Notes

(1) Information on the Cooperative and its Activities. Initial inquiries that may affect planning the examination include the following:

(a) Margin Stabilization Plans. If the cooperative is operating under

a margin stabilization plan, it will be necessary to reconstruct the cooperative's actual income and expense.

(1) Cooperatives must maintain certain financial ratios (*e.g.*, TIER (defined in (12)22(21)) of 1.00 for G&T cooperatives and 1.50 for distribution cooperatives), or their REA loans are in default. To more easily meet the required ratios, some cooperatives seek to average their margins in good and bad years through "margin stabilization." The cooperative selects a target margin (usually REA's required TIER of 1.00 or 1.50) by which income is to exceed expenses. The income shown in financial statements and in the financial reports to REA is the target margin, not the actual income and expense accrued in that year. In a good year, the cooperative books the excess of income over expense as a deferred credit; in a bad year, the operating loss is booked as a deferred charge. GAAP allows this, if certain conditions are met. SFAS No. 71, Accounting for the Effects of Certain Types of Regulation; No. 90, Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs; or No. 92, Regulated Enterprises—Accounting for Phase-in Plans. REA also allows margin stabilization plans if cooperatives meet certain requirements and disclose the plan in their financial statements. See 7 C.F.R. § 1718 (proposed regulations). The deferred charges and deferred credits should appear in Accounts 181-188, 251-253, 255 and 256.

(2) To check for margin stabilization plans, review REA correspondence and accountants' notes to financial statements. (Cooperatives may implement SFAS Nos. 71, 90 or 92 (the basis for margin stabilization plans) only with REA's prior written approval. 7 C.F.R. § 1767.13(d).) REA can verify whether it approved a cooperative's margin stabilization plan. See also REA Publication 201-1, TIER, line 88 (for distribution cooperatives). If TIER on line 88 is exactly 1.50, this may also indicate a margin stabilization plan.

(3) These plans raise issues with respect to the 85 percent test and Rev. Rul. 72-36. See *Technical Instruction Program for FY 1994*,

“Current Issues Affecting Certain Cooperatives and Like Organizations Described Under IRC 501(c)(12)”, 38, 47–49.

(b) Account 923, Outside Services Employed. Entries in this account may reveal payments to accountants, attorneys, appraisers, engineers and other consultants for special reports on financing, construction or rates.

(2) Cooperative Principles, 85 Percent Test and Unrelated Business Taxable Income.

(a) Operating Revenue from Sale of Electricity. A cooperative's electricity customers may vary: residential, commercial, industrial, agricultural, governmental consumers or other public utilities. Review Accounts 440–456 for the 85 percent test and possible unrelated trade or business. To classify sales to members and nonmembers, compare information on members to the persons the cooperative supplies electricity. For example, on Accounts 444, Public Street and Highway Lighting and 445, Other Sales to Public Authorities, ascertain whether the local, state or federal government agency is a member of the cooperative. Ascertain if commercial customers are members or nonmembers. Review Accounts 447, Sales for Resale (and all subaccounts) and 442, Commercial and Industrial Sales for member/nonmember income. (Late payment charges from government customers booked in Account 450, Forfeited Discounts, are not exempt under IRC 103. *Kurtz Bros. v. Commissioner*, 42 B.T.A. 561 (1940) and other authorities cited in *Utilities Handbook* § 437.) The total amount of the electric operating revenue accounts is entered in Account 400, Operating Revenue.

(1) Review Accounts 142, Customer Accounts Receivable; 142.1 Customer Accounts Receivable—Electric; 142.2 Customer Accounts Receivable—Other; 144.1, Accumulated Provision for Uncollectible Customer Accounts — Credit and Account 904, Uncollectible Accounts. *REA Accounting Course* at 214–215. Taxpayers must use the specific charge-off method in accounting for losses on bad debts. Tax Reform Act of 1986, Pub. L. No. 99–514 § 805(a), repealing IRC

166(c) (the reserve method), effective for taxable years beginning after December 31, 1986. Utilities are not barred from charging-off uncollectible accounts merely because they must continue to serve customers in arrears on their accounts. H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., II–314, 1986–3 C.B. (Vol. 4) 314–316. For the change in method of accounting from reserve to specific charge-off and IRC 481(a) adjustment, see Pub. L. No. 99–514 § 805(d)(2). Analyze customer accounts for member/nonmember income.

(2) Account 555, Purchased Power, shows the cost of electricity purchased for resale and all net settlements for exchange of electricity (including economy power, off-peak power for on-peak power and spinning reserve capacity). The cooperative must maintain records showing, by months, the demands, demand charges, kilowatt-hours and prices under each purchase contract and the charges and credits under each exchange or power pooling contract.

(b) Income from Interest and Dividends. Review the following Accounts:

(1) Cash Accounts. Cooperatives must invest cash in income-producing accounts and should give primary consideration to safety and liquidity. 7 C.F.R. §§ 1715, 1789; REA Mortgage; REA Bulletin 1–7, General Funds (12/6/77). Review the cash accounts, trace earnings to the appropriate Revenue Accounts or Income Accounts, ascertain whether earnings are member or nonmember and trace to Form 990. See Accounts 131.1, Cash—General; Cash—Construction Fund—Trustee; 131.3 Cash—Installation Loan and Collection Fund (distribution cooperatives' loans to consumers for installation of appliances). For REA's rules on accounting for cash, see *REA Accounting Course* at 1–25.

(2) Other Investment Funds. Review Accounts 124, Other Investments; 125, Sinking Funds (if applicable); 126 Depreciation Fund; 128, Other Special Funds; 134, Other Special Deposits; 136 Temporary Cash Investments Trace investment income attributable to these Accounts to appropriate income Accounts and Form 990.

(3) CFC. Many cooperatives also borrow from the CFC and pay a membership fee to join CFC. Account 123.23 Other Investments in Associated Organizations. As part of the financing, they execute a subscription agreement with CFC and agree to purchase interest-bearing capital term certificates. These transactions are booked in Accounts 123.21, Subscriptions to Capital Term Certificates—CFC; 224.11, Other Long-Term Debt Subscriptions; 171, Interest and Dividends Receivable; 419, Interest and Dividend Income.

(4) Interest and Dividend Income. Analyze Accounts 171, Interest and Dividends Receivable and 419, Interest and Dividend Income.

(5) Interest Income from “Cushion of Credit Accounts.” Ascertain whether interest income from “cushion of credit accounts” is reported. Cooperatives with REA loans may deposit amounts in cushion of credit accounts at the U.S. Department of the Treasury. These accounts can only be used to pay principal and interest on REA loans. They earn interest at 5 percent (a fixed rate, not based on Treasury's changing cost of funds). When interest rates from other investments fall below 5 percent, cooperatives often increase deposits to their cushion of credit accounts. Transactions in cushion of credit accounts should be booked as follows: Deposits are debited to Account 222.6, Advance Payments Unapplied—LTD Debt and credited to Account 131, Cash. Interest income earned is debited to Account 419 and credited to Account 222.4. Cushion of credit payments (and interest) applied to REA loans are debited to Account 224.3, Long-Term Debt—REA Construction Notes and credited to Account 224.6. The interest earned on cushion of credit accounts should be recorded as interest income and never as a reduction of interest expense. See REA Bulletin 20–9; 320–12 Loan Payments and Statements; REA Bulletin 181–1. If necessary, the examiner can request a transcript of REA's loan receivable accounts for the cooperative and analyze deposits and accrued interest income applied to installments of principal and interest on REA loans.

(6) Notes Receivable. Review Account 141 for amount, timing and source of interest income.

(7) Premium Income. G&Ts using pollution control bond financing or cooperatives borrowing from FFB may have premium income. Cooperatives must maintain separate accounts for premium, discount and expense for each class and series of long-term debt. 7 C.F.R. § 1767.15(q). See Accounts 225, Unamortized Premium on Long-term Debt (amortized monthly under Account 429, (Amortization of Premium on Debt—Credit); Accounting Principle 624, Pollution Control Bonds. See Treas. Reg. § 1.61–12.

(c) Forgiveness of Indebtedness Income from Reacquisition of Long-Term Debt. When cooperatives reacquire or redeem their debt, under the USoA, the difference between the amount paid upon reacquisition and the face value (plus any unamortized premium less any related unamortized debt expense and reacquisition expense) less any unamortized discount, related debt expense and reacquisition expense attributable to the redeemed debt are booked in Account 189, Unamortized Loss on Reacquired Debt or Account 257, Unamortized Gains on Reacquired Debt. These amounts are amortized monthly over the remaining life of the old original debt (Account 428.1, Amortization of Loss on Reacquired Debt; Account 429.1, Amortization of Gain on Reacquired Debt—Credit). Accounting Principle 625, Prepayment of Debt. As stated above, for income tax purposes, discharge of indebtedness income is (nonmember) gross income in the taxable year realized unless TAMRA § 6203 applies. IRC 61(a)(12), 451, 501(c)(12)(C)(ii). Review Accounts 189, 257, 428.1, 429.1.

(d) Rental Income. Analyze Account 172, Rents Receivable and 418, Nonoperating Rental Income. Review Accounts 104, Electric Plant Leased to Others; 412, Revenues from Electric Plant Leased to Others; 413, Expenses of Electric Plant Leased to Others) for source and amount of rental income for the 85 percent test (including qualified pole rentals, if any) and unrelated trade or business taxable income. Qualified pole rentals are recorded in Account 454, Rent from Electric

Property. See *Utilities Handbook* § 44(12) on joint use of poles.

(e) Gains and Losses. The USoA rules on plant accounting and realization differ from the income tax rules on adjusted basis and realization:

(1) Accounting for Utility Plant. Utility plant is the largest asset account on the balance sheet. REA plant accounting differs radically from income tax accounting in many ways (e.g., acquisitions, retirements and depreciation reserves). *Utilities Handbook* §§ 230, 426.

(2) Work in progress appears in Account 107, Construction Work in Progress—Electric. 7 C.F.R. § 1767.16(a)–(d), (f)–(h) (detailed discussion of multiple expenditures covered). On booking additions and retirement of plant, see 7 C.F.R. § 1767.16(j); Account 102, Electric Plant Purchased or Sold; Accounts 301–399; Account 101, Electric Plant in Service. Some REA capitalization, basis and depreciation rules diverge from income tax accounting (e.g., Account 419.1, Allowance for Funds Used During Construction (imputed interest income for rate-making purposes only), booked to Account 101, must be eliminated to compute adjusted basis in utility plant). For equipment, see 7 C.F.R. § 1767.16(i). On basis and depreciation, see *Utilities Handbook* §§ 426, 445. The cooperative's CPA is required to test utility plant and depreciation accounts for additions, replacements, retirements and construction work in process. 7 C.F.R. § 1773.39. If appropriate, request the CPAs' workpapers.

(3) Transfer of Electric Plant and Other Property. When electric plant is transferred, the book cost of the transferred plant is debited to Account 102, Electric Plant Purchased or Sold (a suspense account) and credited to the appropriate plant account(s) and the accumulated depreciation amount (Accounts 108, 115, 119) (and any amount in Account 252, Customer Advances for Construction) are charged to those Accounts. This net amount, minus the consideration received for the transferred plant (less expenses of sale) is then credited to Account 102 and, if a "significant" amount, closed into Accounts 256, Deferred Gains from Disposition of Utility

Plant or 187, Deferred Losses from Sale of Utility Plant and amortized over five years (generally) in, respectively, Accounts 411.6, Gains from Disposition of Utility Plant and 411.7, Losses from Disposition of Utility Plant. Nonsignificant gains and losses are closed into Accounts 421.1, Gain on Disposition of Property or Account 421.2, Loss on Disposition of Property. 7 C.F.R. § 1767.16(e); *REA Accounting Course* at 296–297.

(4) Income Tax Accounting. Gains and losses from disposition or retirement of utility plant and other assets is included in gross income in the taxable year realized and recognized. IRC 1001, 1231, 451; Treas. Reg. § 1.167(a)–11(d) for pre-ACRS property. Review and reconcile activity in these Accounts with income tax accounting rules. *Utilities Handbook* §§ 433, 445.

(5) Gains and Losses on Transfers of Other Property. For other property (e.g., land or land rights), see Accounts 421.1, Gain on Disposition of Property or Account 421.2, Loss on Disposition of Property. 7 C.F.R. § 1767(e)(5). Accounting Principles 128, Sale of Property; 129, Gain or Loss on the Sale of an Office Building.

(f) Transfer of Clean Air Act Allowances.

(1) The Clean Air Act Amendments of 1990 (the Act). The Act established a system to issue emission allowances for airborne pollutants, implemented by the Environmental Protection Agency (EPA). Electric utilities (including G&Ts) are issued emission allowances authorizing the emission of a specified amount of airborne pollutants by the utility during a specified calendar year or later period. Starting in 1993, unused allowances may be sold, traded or held in inventory for use against emissions in future years.

(2) Accounting for Allowances. Account 158.1, Allowance Inventory, includes the cost of allowances owned by the G&T and not withheld by the Environmental Protection Agency. (See Account 158.2, Allowances Withheld, for treatment of withheld allowances.) Concurrent with the cooperative's monthly emission of sulfur dioxide, Account 158.1 is credited and Account 509,

Allowances, is debited. Separate subdivisions of the Account are maintained to separately account for allowances usable in the current year and those used in subsequent years. The records should be sufficiently detail to identify each allowance, its origin, and the acquisition cost, if any. The cost of allowances owned by the G&T, but withheld by the EPA, are included in Account 158.2. Upon release of the allowance for use by the G&T, inventory cost is transferred to Account 158.1.

(3) Gains and Losses. G&Ts may realize gains and losses from the disposition of allowances or options on allowances. Accounting treatment of dispositions of allowances under the USoA varies depending on whether the allowance is held for speculative purposes:

(a) Nonspeculative Gains and Losses. Gains on dispositions of allowances not held for speculative purposes are credited to either: (1) Account 254, Other Regulatory Liabilities, when there is uncertainty as to the existence of a regulatory liability or definite regulatory liability; or (2) Account 411.8, Gains from Disposition of Allowances. Losses that qualify as regulatory assets are charged to Account 182.3, Other Regulatory Assets. All other losses are charged to Account 411.9, Losses from Disposition of Allowances.

(b) Speculative Gains and Losses. Gains on disposition of allowances held for speculative purposes appear in Account 421, Miscellaneous Nonoperating Income. Losses are charged to Account 426.5, Other Deductions. Costs and benefits of exchange-traded allowance futures contracts used to protect a utility from the risk of unfavorable price changes (hedging transactions) are deferred in Account 186, Miscellaneous Deferred Debits, or Account 253, Other Deferred Credits. The deferred amounts are included in Account 158.1 in the month in which the related allowances are acquired, sold or otherwise disposed of. Where the costs or benefits of hedging transactions are not identifiable with specific allowances, amounts are included in Account 158.1 when the contract closes.

(4) Income Tax Accounting. Examine Account 158.1 to ascertain

gains and losses realized from disposition of air emission allowances. Rev. Proc. 92-1, 1992-2 C.B. 503, discusses the federal income tax consequences of the air emission allowance program. Contact the Office of the Assistant Chief Counsel (Income Tax and Accounting) for further assistance in determining the income tax consequences of transactions involving the sale or exchange of allowances.

(g) Associated (Affiliated) Companies and Subsidiaries. These Accounts may raise issues concerning the 85 percent test, operation as a cooperative, unrelated trade or business and employment taxes.

(1) A cooperative's investment in an associated company embraces corporations, joint ventures and funded deferred compensation plans. Cooperatives must keep accounts and records to accurately report transactions with subsidiaries. 7 C.F.R. § 1767.15(n). Accounting Principle 623, Satellite or Cable Television Services. The results of subsidiaries' operations appear on the cooperative's balance sheet in Accounts 123.11, Investment in Subsidiary Companies; 418.1, Equity in Earnings of Subsidiary Companies and 216.1, Unappropriated Undistributed Subsidiary. Accounting Principle 623, Satellite or Cable Television Services; FAS No. 94.

(2) Review Accounts 123, Investment in Associated Companies; 123.23, Other Investments in Associated Organizations; 136, Temporary Cash Investments; 145, Notes Receivable from Associated Companies; 233, Notes Payable to Associated Companies; 146 Accounts Receivable from Associated Companies; Accounts Payable to Associated Companies; 223, Advances from Associated Companies. These accounts show the book cost of investments in securities issued (or assumed by) each associated company and joint venture, the cooperative's investment advancements and any accrued interest on any debt. Amortization of discount or premium on interest-bearing investments is booked in Account 419, Interest and Dividend Income. Write-offs appear in Account 426.5, Other Deductions.

(h) Economic Development Loan Fund. Cooperatives are en-

couraged to participate in REA's Rural Economic Development Loan and Grant Program. REA provides interest-free loans or grants to cooperatives to promote rural economic development and job-creation projects, through revolving loan funds and pass-through grants. See 7 C.F.R. § 1703, Subpart B (including final regulations published in 59 Fed. Reg. 11702 (Mar. 14, 1994)); Accounts 131.12, Cash-General-Economic Development Loan Funds; 224.16, Long-Term Debt—REA Economic Development Notes Executed; 224.17, REA Notes Executed—Economic Development—Debit; Accounting Principle 626, Rural Economic Development Loan and Grant Program. Analyze activity in these accounts in connection with the 85 percent test.

(i) Miscellaneous. Entries in the following accounts may reveal member, nonmember or unrelated trade or business income:

(1) Accounts 105, Electric Plant Held for Future Use; 121, Nonutility Property or 389-399, General Plant (particularly Account 397, Communication Equipment) may suggest nonmember income and/or unrelated business (*e.g.*, non-cooperative cable TV service dealing with nonmembers) See also, Accounting Principle 623, Satellite or Cable Television Services.

(2) Sale of Nuclear Materials (as opposed to reuse): Account 157, Nuclear Materials Held for Sale is debited for salvage value; Account 120.5, Accumulated Provision for Amortization of Nuclear Fuel Assemblies is credited. Any difference between salvage value and the amount realized is credited/debited to Account 518, Nuclear Fuel Expense.

(3) Make Ready Charges Received from Cable Television Companies. The cooperative and a cable television company (an affiliate or an unrelated firm) may agree to place lines, attachments or apparatus on the cooperative's poles for transmission of TV signals. See REA Bulletin, Joint Use Agreement With CATV Companies. To make ready the poles, the cooperative incurs labor and materials costs. Make ready charges may be booked in several ways: as a reimbursement (Accounting Principle 135, Account-

ing for Removal or Relocation of Electric Facilities Resulting from the Action of Others (*Reimbursement*)); as contract work (Account 415, Revenues from Merchandising, Jobbing and Contract Work) or as reductions in expenses (Account 142.2, Customer Accounts Receivable—Other (when the invoice is paid, cash is credited and maintenance and operation expenses are debited)).

(4) Sales of Timber, Sand and Gravel. See 7 C.F.R. § 1767.16(g)-(3). Account 421, Miscellaneous Nonoperating Income.

(3) Patronage Capital. Cooperatives must keep detailed records on names and addresses of members and a patronage capital ledger. Accounts 200; 201.1. See GAO Reports RCED 93-164; GGD-83-7.

(a) The Patronage Capital Cycle. As discussed above, cooperatives must operate on a cooperative (nonprofit) basis. The excess of operating revenues over operating expenses for each year is considered to be capital furnished by members (patrons). Such capital or margins is to be assigned to members on the basis of each year's margins. See Exhibit 12(20)-1. This is done as follows:

(1) At the end of each year, revenue and expense from sale of electricity (income and expense netted from Accounts 400-408; 412-414; 423-428; 431) are closed into Account 219.1, Operating Margins. Note: Accounts 219.1 and 219.2 cannot be used (unless adjusted) to check the 85 percent test because they reflect net income from operations and because the income accounts do not uniformly parallel member/nonmember classifications in IRC 501(c)(12).

(2) The balance in Account 219.1 is then transferred to Account 201.2, Patronage Capital Assignable. (If the amount in Account 219.1 is a deficit, the amount is not transferred to Account 201.2.) Patronage capital is assigned to individual members on the basis of patronage, pursuant to the cooperative's bylaws.

(3) After the margins are allocated to members, this amount is transferred from Account 201.2 to Account 201.1, Patronage Capital Credits.

(4) Nonoperating margins from other activities (Accounts 415-417; 417.1, 418-419; 419; 421, 421.1, 421.2, 422, 434-435) are closed into Account 219.2, Nonoperating Margins. If the cooperative's bylaws permit, nonoperating margins may be assigned to members. Accounts 219.1, 219.2, 219.3, Other Margins; 219.4, Other Margins and Equities—Prior Periods which are assignable to patrons (members) are transferred to Account 201.2 and 201.2 (as above).

(5) When the board of directors authorizes the return of capital credits to patrons, the amount authorized is transferred to Account 238.1, Patronage Capital Payable. See Accounting Principles 501, Patronage Capital Assignments; 502 Patronage Capital Retirements; 503 Operating and Nonoperating Margins; 504, Patronage Capital from G&T Cooperatives, 505, Patronage Capital Furnished by Other Cooperative Service Organizations.

(6) Forfeited membership fees appear in Account 208, Donated Capital. See Accounting Principle 506, Forfeited Membership Fees. Ascertain whether forfeitures are treated consistently with Rev. Rul. 72-36, Q&A 4.

(b) The cooperative's CPAs must analyze patronage capital accounts and a sample of membership transactions. 7 C.F.R. § 1773.43(b), (c).

(c) Electric cooperatives are not required to file Forms 1099 to report payments of patronage dividends. Treas. Reg. § 301.6044-2(b)(2)(iii).

(d) Review the patronage capital credits allocated to a distribution and transmission cooperative by G&T Cooperatives. Account 123.1, Patronage Capital from Associated Cooperatives.

(4) Unrelated Business Taxable Income. Entries in the following Accounts may suggest unrelated trade or business:

(a) Accounts 415, Revenues from Merchandising, Jobbing and Contract Work; 416, Costs and Expenses of Merchandising, Jobbing and Contract Work; 417 Revenues from Nonutility Operations (*e.g.*, cable TV or furnishing management or engineering services to others); 417.1, Expenses of Nonutility Oper-

ations; 418, Nonoperating Rental Income (net income from real property, equipment, intangibles (*i.e.*, from Nonutility Property in Account 121)); 421, Miscellaneous Nonoperating Income (net gain from disposition of investments (7 C.F.R. § 1767.15(q)); net income from timber sales (7 C.F.R. § 1767.16(g)(3)); net profit on certain contracts); 434 Extraordinary Income; 435, Extraordinary Deductions; 451, Miscellaneous Service Revenues. Accounting Principle 623, Satellite or Cable Television Services.

(b) Allocation of Expenses. Cooperatives must keep accurate records of payroll distribution by function. Because REA finances only capital items (new construction and replacement) but not operating expense, the USoA requires detailed allocations of labor and materials expense between these functions. These records may assist the examiner with allocating expenses under Treas. Reg. § 1.512(a)-1(c). 7 C.F.R. §§ 1767.15(i), (j); 1767.17; 1767.27 (Accounts 500-598); Accounts 163, Stores Expense Undistributed. Cooperatives often share facilities, equipment or labor between furnishing electricity and television services. GAO Report 93-164.

(5) Retirement or Pension Plans, Other Deferred Compensation Arrangements and Employee Benefits. The cooperative may maintain one or more qualified or nonqualified plans.

(a) Examination of Qualified Plans. Determine what plans a cooperative maintains, and the type of plan. Where necessary, seek the assistance of an Employee Plans Specialist for further analysis of the plans and to make sure that there are no problems with participation, discrimination, contributions or benefits levels, vesting, funding, portability, or the security of pension investments. Review Account 228.3, Accumulated Provisions Pensions and Benefits and any Account 128 sub-accounts, Other Special Funds—Deferred Compensation; Special Funds Reserve—Deferred Compensation. Accounting Principle 604.

(b) Examination of Non-qualified Plans. Seek the assistance of a deferred compensation specialist in the Office of Associate Chief Counsel (Employee Benefits & Ex-

empt Organizations) for further analysis of the plans. To review non-qualified deferred compensation plans and other employee benefits, see Accounts 128, Other Special Funds and Account 123, Investment in Associated Companies (and sub-accounts). See Accounting Principle 604, Deferred Compensation.

(6) Employment Taxes. Employment taxes paid and accrued appear in Accounts 236.3, Accrued U.S. Social Security Tax—F.I.C.A. (employer's share of F.I.C.A.); 408.2 Accrued U.S. Social Security Tax—Unemployment; 408.3, U.S. Social Security Tax—F.I.C.A.; 236.7, Accrued Taxes—Other; 408.7 Taxes—Other; 241.1, Tax Collections Payable—F.I.C.A. (employee's share of F.I.C.A. collected by employer). Purchase rebates received from materials and supplies vendors may be in the form of package travel arrangements. The board of directors decides who receives these benefits. The contra charge for the reduction in cost is posted to Account 926, Employee Pensions and Benefits (for employees) or to Account 930.2, Miscellaneous General Expenses (for directors and members). Accounting Principle 620, Purchase Rebates.

(7) Other Accounts to be Reviewed. For compliance with the 85 percent test and employment tax reporting, review Accounts 143, Other Accounts Receivable (amounts due from employees to be separately stated); 144.3, Accumulated Provision for Uncollectible Accounts, Officers and Employees—Credit; Account 904, Uncollectible Accounts, Account 920, Administrative and General Salaries (salaries, bonuses and compensation for officers and other employees not chargeable to a particular operating function). Compensation expense for operating functions appear in other expense accounts. Account 926, Employee Pensions and Benefits, shows current accrued expense for qualified employee retirement plans, nonqualified unfunded plans, life insurance, accident and health benefits, educational and recreational activities for the benefit of employees. On nonqualified deferred compensation plans maintained by the cooperative, Account 926 may reflect accrued employee benefit expense netted against investment income. The investment income is included in computing the 85 percent test. Accounting Principles 601, Employee Benefits; 602

Compensated Absences; 603, Employee Retirement and Group Insurance; 604, Deferred Compensation; 605, Life Insurance Premium on Life of a Borrower Employee; 606, Pension Costs; 607, Unproductive Time; 608, Training Costs, Attendance at Meetings, etc.; 627, Postretirement Benefits.

(12)22(18) Analysis of Statement of Cash Flows

Cooperatives' financial statements must include a statement of cash flows. FAS No. 95, "Statement of Cash Flows." The statement provides information on the cooperative's ability to generate positive cash flows, to pay patronage dividends and need to borrow funds. This statement may assist the examiner in assessing whether the cooperative operates according to cooperative principles (including the reasonableness of cash reserves). See sample statement of cash flows in 7 C.F.R. § 1789, Appendix A; *REA Accounting Course* at 270-281. Analyze the statement of cash flows (or, if a condensed statement of cash flows is used, a more detailed cash flows statement). If appropriate, request the underlying workpapers. See IRM 7(10)44.(10)4.

(12)22(19) COBRA Continuation Coverage

(1) If a cooperative maintains a group health plan, the plan may be subject to the COBRA continuation coverage requirements under IRC 4980B. Under those requirements, plans generally must make continuation coverage available to beneficiaries losing coverage under the plan due to certain events, such as termination of employment, death, or divorce. IRC 4980B imposes an excise tax for failures to comply with the COBRA continuation coverage requirements. The excise tax is generally \$100 per day for each beneficiary affected by the noncompliance. Two exceptions may apply to plans of cooperatives so that the excise tax of IRC 4980B would not apply.

(a) First, if the plan constitutes a governmental plan under IRC 414(d), then the excise tax would not apply.

(b) Second, if the employers maintaining the plan employ in the aggregate fewer than twenty employees (including independent

contractors eligible for coverage under the plan), then the excise tax does not apply.

(2) For more information on the excise tax of IRC 4980B, see the *COBRA Employee Benefit Continuation Coverage Examination User's Guide (January 1994)*.

(12)22(20) Nonexempt Electric Cooperatives

(1) Overview. If it is necessary to prepare a Form 1120 for any years under examination, seek assistance from the Utilities Industry Specialist (e.g., Schedule M adjustments, when utility plant is placed in service, MACRS, alternative minimum tax) from the Farmers' Cooperatives Industry Specialist (e.g., IRC 277) and, if appropriate, the Media/Communications Industry Specialist and the VEBA (Voluntary Employees' Beneficiary Association) Industry Specialist (IRC 501(c)(9), 419, 419A (including differences in calculations for IRC 419A and FAS No. 106). Many aspects of the USoA not covered in these guidelines (e.g., plant accounts and deferred taxes accounts) may be useful in preparing Form 1120. See also *Utilities Handbook Exhibits*.

(2) Patronage Deductions. Nonexempt cooperatives not subject to Subchapter T may exclude patronage dividends paid or allocated to patrons, according to their bylaws. Rev. Rul. 83-135, 1983-2 C.B. 149. Information from the cooperative will be needed to analyze patronage and nonpatronage income and expense (e.g., analysis of maturity of certificates of deposits.)

(3) IRC 277. Nonexempt electric cooperatives are subject to IRC 277, a method of accounting as defined in IRC 446. Treas. Reg. § 1.446-1(e)(2)(ii)(a); *Concord Consumers Hous. Coop. v. Commissioner*, 89 T.C. 105, 116 (1989); Rev. Rul. 90-38, 1990-1 C.B. 57.

(12)22(21) Definitions

(1) See 7 C.F.R. §§ 1767.10, 1773.2 for definitions used in the USoA. For convenience, certain definitions are reproduced here:

(2) "Associated (or affiliated) companies" are persons that are directly or indirectly (through one or more intermediaries) control or are controlled by,

or under common control with, the cooperative. 7 C.F.R. § 1767.10.

(3) “Control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a company, whether such power is exercised alone, through one or more intermediary companies, or in conjunction with or pursuant to an agreement and whether such power is established through a majority or minority ownership or through voting of securities; common directors, officers or stockholders; voting trusts, holding trusts, associated companies; contracts, or any other direct or indirect means. 7 C.F.R. § 1767.10.

(4) “Subsidiary company” is a company controlled by the cooperative through ownership of voting stock. 7 C.F.R. § 1767.10.

(5) Financial Ratios. REA tracks financial ratios on cooperatives’ operations. Some may interest examiners (e.g., net working capital in relation to reasonable cash reserves). See *REA Accounting Course* at 257–287. “TIER” (times interest earned ratio) equals:

$$\frac{\text{(patronage capital and margins)} + \text{(interest on long-term debt)}}{\text{interest on long-term debt}}$$

TIER appears on line 88 of REA Publication 201–1. Patronage capital and margins appear on line 50; interest on long-term debt on line 48. Example: Patronage capital and margins is \$600,000. Interest on long-term debt is \$500,000. TIER is 2.20:

$$\frac{(600,000 + 500,000)}{500,000}$$

(12)22(22) Additional References

(1) Internal Revenue Service:

- (a) Technical Instruction Program (1977—current).
- (b) ISP Coordinated Issue Papers.
- (c) *Exempt Organizations Handbook*.
- (d) *Specialized Industry Audit Guidelines—Public Utilities (Utilities Handbook)*.
- (e) “More Basics: the Basics of Fringe Benefits” and User Guide (Chief Counsel Technical TV) (1994).

(f) *COBRA Employee Benefit Continuation Coverage Examination User’s Guide* (January 1994).

(g) *Office of Chief Counsel Telephone Directory and Subject Matter Directory*, Document 7801 (including Utilities ISP, Media/Communications ISP, Farmers’ Cooperatives ISP and VEBA (Voluntary Employees’ Beneficiary Association) ISP).

(2) General Accounting Office:

- (a) *Generally Accepted Government Auditing Standards* (GAGAS or Yellow Book) (rules for required reports on electric and telephone cooperatives prepared by independent CPAs).
- (b) *Legislation Needed to Improve Administration of Tax Exemption Provisions For Electric Cooperatives*, GGD–83–7 (1983).
- (c) *REA Borrowers’ Investment in Cable and Satellite Television Services*, RCED–93–164 (1993).
- (d) To order GAO reports, call (202) 512-6000 or fax (301) 258-4066. The first copy is free. Additional copies are \$2.00.

(3) Federal Energy Regulatory Commission (FERC):

- (a) Uniform System of Accounts, 18 C.F.R. § 101 *et seq.*
- (b) *Glossary of Important Power and Rate Terms, Abbreviations and Units of Measurement*, Interagency Committee on Water Resources (Federal Power Commission 1965).

(4) Rural Electrification Administration:

- (a) Rural Electrification Act of 1936 (With Amendments as Approved Through December 17, 1993), Informational Publication 100–1 (1993) (chronology of amendments, text of statute and guide to provisions).
- (b) Uniform System of Accounts (Electric), 7 C.F.R. § 1767 *et seq.* (1994) (58 Fed. Reg. 59822 (1993)) (or see REA Bulletin 1767–B (1993)) (USoA).
- (c) Policy on Audits of REA Borrowers, 7 C.F.R. § 1773 (requirements for audit of cooperatives by independent CPA under GAAP and GAGAS).
- (d) Margin Stabilization Plans, Revenue and Expense Deferrals, and Refunds of Previously Recorded Revenues, 7 C.F.R. § 1718 (proposed regulations) (53 Fed. Reg. 44887 (1988)).

(e) Note on REA regulations: REA regulations are available in hard copy (Code of Federal Regulations, published annually) and on disk in ASCII. Contact the National Office for additional information.

(f) REA Forms 7 Financial and Statistical Report, Operating Report — Financial, Form 12.

(g) *Guide for Preparing Financial and Statistical Reports for Power Supply Borrowers and Electric Distribution Borrowers with Generating Facilities*, Bulletin 1717B–3.

(h) *Guide for Preparing Financial and Statistical Reports for Electric Distribution Borrowers*, Bulletin 1717B–2.

(i) REA Standard Mortgage.

(j) *A Brief History of the Rural Electric and Telephone Programs and Report of the Administrator*, Fiscal Year 1992 Informational Publication 100–7.

(k) *REA Financed Generating Plants*, Informational Publication 200–2 (1993).

(l) *1992 Statistical Report, Rural Electric Borrowers*, Informational Publication 201–1.

(m) REA Bulletins (selected):

(1) Evaluation and Enforcement of Internal Control of Borrowers’ Enterprises, 182–1 (1/10/65).

(2) Procedures for Computing and Recording Capital Credits, Section 1951, Issue 2 (7/64).

(3) Capital Credits—Consumer Benefits, 102–1 (Electric) (7/64, reprinted 7/28/74).

(4) General Funds, 1–7 (12/6/77) (cash management guidelines).

(5) Joint Use Agreement With CATV Companies (joint use of utility poles), 1726A–125 (9/17/93).

(n) REA Accounting Interpretations.

(o) *REA Telephone Directory*, Informational Publication 500–1.

(5) Graduate School, U.S. Department of Agriculture:

REA Borrower Accounting (Electric), Correspondence Program course guide (1991) (*REA Accounting Course*).

(6) National Association of Regulatory Utility Commissioners (NARUC):

(a) *Utility Regulatory Policy in the United States and Canada*, (1992) (guide to state rate regulation of electric cooperatives).

(b) To order NARUC publications, call (202) 898-2200 or fax (202) 898-2213.

(7) American Institute of Certified Public Accountants (AICPA):

(a) *Audit and Accounting Guide: Consideration of Internal Control Structure in a Financial Statement Audit* (1990).

(b) *Audit Risk Alerts* (matters of interest to CPAs in planning audits, issued annually).

(8) Treatises:

(a) J. Bonbright, *Principles of Public Utility Rates* (1988).

(b) R. Hahne, G. Aliff, *Accounting for Public Utilities* (1993).

(c) M. Reeser, *Introduction to Public Utility Accounting* (1984).

(d) Pacific Gas and Electric, *Resource: An Encyclopedia of Utility Industry Terms* (1984).

(e) *Glossary of Cable & TV Terms*, National Cable Television Association, A.C. Nielsen Co. (1981).

(f) M. Abrahamsen, *Cooperative Business Enterprise* (1976).

(g) I. Packel, *The Organization and Operation of Cooperatives* (4th ed. 1970).

(h) G. Bauernfeind, *Income Taxation: Accounting Methods and Periods* (1992).

(9) Periodicals:

(a) *The Cooperative Accountant*
National Society of Accountants
for Cooperatives.

(b) *Journal of Accountancy*
AICPA.

(c) *Electric Utility Week*
McGraw-Hill.

(d) *Electrical World*
McGraw-Hill.

(e) *The Energy Daily*
King Publications Group.

(f) *Fortnightly* (formerly *Public Utilities Fortnightly*) Public Utilities Reports.

(g) *Rural Electrification*
National Rural Electric Cooperative Association (NRECA).

(h) *NRECA's Power Supply Report*.

(i) *Rural Electric Newsletter*
NRECA.

(j) *Electric Power Alert*
Inside Washington Publishers.

(k) *Broadcasting & Cable*
Cahners Publishing Co./Reed
Publishing.

(l) *Cablevision*
Diversified Publishing Group.

(m) *Telecommunications Policy*
BRP Publications, Inc.

(12)22(23) Exhibits

Exhibit 12(20)-1, "Summary of Accounts Used in Connection with Recording Patronage Capital" (reproduced with the compliments of the Graduate School, U.S. Department of Agriculture, from the Correspondence Program course *REA Borrower Accounting (Electric)*, copyright (c) 1991).

Exhibit 12(20)-2, "Applying the 85 Percent Test: Analysis of REA Uniform System of Accounts (Selected Revenue, Income, Expense and Balance Sheet Accounts)."

Applying the 85 Percent Test: Analysis of REA Uniform System of Accounts (Selected Revenue, Income, Expense and Balance Sheet Accounts)¹

USoA	Account Name	Non-Member	Member	Excluded
411.6	Gains from Disposition of Utility Plant [1]		X	
411.7	Losses from Disposition of Utility Plant [1]		X	
411.8	Gains from Disposition of Allowances [1]		X	
411.9	Losses from Disposition of Allowances [1]		X	
412	Revenues from Electric Plant Leased to Others		X	
414	Other Utility Operating Income [2]	X	X	
415	Revenues from Merchandising, Jobbing and Contract Work	X	X	
418	Nonoperating Rental Income [2]		X	
418.1	Equity in Earnings of Subsidiaries [1]	X	X	
419	Interest and Dividend Income [2]		X	
419.1	Allowance for Funds Used During Construction [1]	N/A	N/A	N/A
421	Misc. Nonoperating Income [2], [4]		X	
421.1	Gain on Disposition of Property [1]		X	
421.2	Loss on Disposition of Property [1]		X	
428.1	Amortization of Loss on Reacquired Debt [1]		X	
429	Amortization of Premium on Debt — Credit [1]		X	
429.1	Amortization of Gain on Reacquired Debt [1], [4]		X	X
434	Extraordinary Income [2]		X	
440	Residential Sales [3]	X	X	
440.1	Residential Sales—Excluding Seasonal [3]	X	X	
440.2	Residential Sales—Seasonal [3]	X	X	
441	Irrigation Sales [3]	X	X	
442	Commercial and Industrial Sales [3]	X	X	
442.1	Commercial and Industrial Sales—1000 kVA or Less [3]	X	X	
442.2	Commercial and Industrial Sales—Over 1000 kVA [3]	X	X	
444	Public Street and Highway Lighting [3]	X	X	
445	Other Sales to Public Authorities [3]	X	X	
446	Sales to Railroads and Railways [3]	X	X	
447	Sales for Resale [3]	X	X	
447.1	Sales for Resale to REA Borrowers [3]	X	X	
447.2	Sales for Resale—Others [3]	X	X	
448	Interdepartmental Sales [1]	N/A	N/A	N/A
449.1	Provision for Rate Refunds [4]	X	X	
450	Forfeited Discounts [4]	X	X	
451	Misc. Service Revenue	X	X	
453	Sales of Water and Water Power	X	X	
454	Rent from Electric Property	X	X	X
456	Other Electric Revenue		X	
158.1	Allowance Inventory		X	

Legend:

[1]: This Account requires an adjustment for differences between regulatory and income tax accounting.

[2]: This Account combines revenue and expense.

[3]: This Account may require an adjustment to comply with IRC 451(f).

[4]: This Account may require an adjustment for other timing differences between regulatory and income tax accounting.

N/A: Not applicable.

¹This Exhibit is a general guide to the range of classification of USoA revenue and income accounts for purposes of IRC 501(c)(12)(A), (C). Some Accounts may contain member, nonmember or excluded income (alone or in combination), depending upon the nature of the transactions, the parties thereto and/or in what taxable year the transactions occurred.

PUBLIC COMMENTS

These proposed examination guidelines address specific issues relating to rural electric cooperatives. Because they address matters that may have a significant impact on these cooperatives, the Service is soliciting public comments on them.

Comments should be submitted in writing on or before June 14, 1996.

Comments should be sent to the following address:

Internal Revenue Service
Assistant Commissioner
(Employee Plans and Exempt
Organizations) Attn:
CP:E:EO:T:3, Rm. 6137
Washington, DC 20224

If warranted, after consideration of the comments received, the Service will schedule a public hearing to discuss

these proposed guidelines before they are finalized.

DRAFTING INFORMATION

The person to contact regarding this announcement is Edward Karcher of the Exempt Organizations Division. For further information you can contact Mr. Karcher on (202) 622-8120 (not a toll-free number).

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal

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

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

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

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Miller, Gorden A.	Mineral Wells, WV	CPA	February 1, 1996 to April 30, 1996
Barnes, Charles E.	Louisville, KY	Enrolled Agent	Indefinite from February 1, 1996
Polizzi, Angelo J.	Grosse Point, MI	Attorney	Indefinite from February 6, 1996
Pegler, Charles R.	Islandia, NY	CPA	Indefinite from February 7, 1996
Foster, David M.	Birmingham, MI	Attorney	Indefinite from February 9, 1996
Smith, Jerry A.	Evansville, IN	CPA	February 9, 1996 to November 8, 1996
Penn, Michael J.	Dearborn, MI	CPA	February 9, 1996 to February 8, 1997
Mueller, E. Laird	Seal Beach, CA	CPA	February 12, 1996 to June 11, 1996
Zeizima, Paul P.	Norwalk, CT	CPA	April 1, 1996 to May 31, 1996
Van Houten, Robert R.	Danbury, CT	CPA	May 1, 1996 to April 30, 1997

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly

or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

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

agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Gimbel, Stephen	Columbia, SC	CPA	January 20, 1996
Tropsa, Donna C.	Stamford, CT	Attorney	January 20, 1996
Seifert, Frank J.	Birmingham, AL	CPA	January 20, 1996
Hansen, Joe B.	Lubbock, TX	CPA	March 2, 1996

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

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

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal

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

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

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

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

Name	Address	Designation	Date of Suspension
Ginsberg, Melvin R.	Univ. Heights, OH	Attorney	Indefinite from January 24, 1996
Lahey, Charles W.	South Bend, IN	Attorney	Indefinite from January 24, 1996
DePiano, Robert	Venice, CA	Attorney	Indefinite from January 24, 1996
Kraig, Jerry B.	Shaker Hgts, OH	Attorney	Indefinite from January 29, 1996
Brown, David M.	Los Angeles, CA	Attorney	Indefinite from January 29, 1996
Hanke Jr., Dale L.	Duluth, MN	Attorney	Indefinite from February 1, 1996
Guillory, Patrick R.	San Francisco, CA	Attorney	Indefinite from February 1, 1996
Miller, Brian R.	Grove, OK	CPA	Indefinite from February 23, 1996
McLeod, Timothy R.	Saginaw, MI	Attorney	Indefinite from February 26, 1996
Simone, Robert F.	Philadelphia, PA	Attorney	Indefinite from February 26, 1996
Bowen, David Lee	Frisco City, AL	CPA	Indefinite from February 27, 1996
Lindley, Clarkson	Wayzata, MN	Attorney	Indefinite from February 27, 1996

Definition of Terms

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

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

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.

E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.

PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹A 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.