

along with its responsible officers and wholesale and retail baker members in Washington State, to cease conspiring among themselves and with others to fix and adhere to prices, terms or conditions of sale of bread, and to deter or attempt to deter any competitor from exercising his individual judgment as to prices and terms of sale.

The order to cease and desist, including further order requiring report of compliance therewith, is as follows:

It is ordered, That respondent Bakers of Washington, Inc., an incorporated association, and respondents George B. Buchan and Richard Hoyt, individually and as officers of respondent association, and respondents Buchan Baking Co., Continental Baking Company, Langendorf United Bakeries, Inc., Hansen Baking Co., Inc., Trenerry's Bakery Co., and Snyder's Bakery, Inc., corporations, John M. Larson, trading as Larson's Bakery, and Vic H. Goethals, trading as Fortune's Bakery, all members of respondent association; and the following members of said association: Ruth Ashbrook Bakeries Corp., 1407 11th Avenue, Seattle, Washington; Albertson's Inc., 17000 Aurora Avenue, Seattle; Baders' Dutch Bakeries, 3755 University, Seattle; Baker Boy Bakery, 8050 Bothell Way, Seattle; Bake-Rite Bakery, 1414 14th Avenue, Seattle; Bellinger Bakery, North Bend; Best Pie Company, Inc., 132 Queen Anne Avenue, Seattle; Big Four Donut, Inc., 319 Nickerson Street, Seattle; Blake's Bakery, Inc., 4729 California Avenue, Seattle; Bookter's Seattle Bakery, Inc., 3409 4th Avenue, South, Seattle; Butter-Krisp Bakery, Inc., 2203 23d Avenue, South, Seattle; Boldt's Western Hotels Food Service, Inc., Boeing Cafeteria, Boeing Plant No. 2, Seattle; Carolyn's Cakes, 518 15th Avenue, North, Seattle; Caster's Lake City Bakery, 12532 Bothell Way, Seattle; Frederick & Nelson (Bakery Department), 5th at Pine, Seattle; Gai's Seattle French Baking Co., Inc., 2006 Weller Street, Seattle; Golden Rule Bakery, Inc., 4450 Fremont Avenue, Seattle; Grandma Cookie Baking Co., Inc., 3402 Wallingford Avenue, Seattle; Karl's Bakery, 1614 Hewitt Avenue, Everett; Kent Bakery, 213 First South, Kent; Lippman's Bakery, Inc., 119 23d Avenue, Seattle; Lindsay's Thriftway Market, 11100 Roosevelt Way, Seattle; Manning's, Inc., 621 Seaboard Building, Seattle; Richard's Fried Pies, Inc., 220 1st Avenue, North, Seattle; Swiss Pastry & Candy Shop, 1325 5th Avenue, Seattle; Smith & Sonleitner Cookie Co., 1238 No. 99 W., McMinnville, Oregon (7710 Bagley, Seattle, Washington); Van de Kamp's Holland Dutch Bakers, 823 Yale Avenue, North, Seattle; Grand Central Bakery, Market and H Streets, Aberdeen; Swanson's Food, Inc., 1401 Simpson Avenue, Aberdeen; Veldkamp's Olympic Bakery, 417 W. Wishkah Street, Aberdeen; Bame's Ye Olde Home Bakery, Riverside, Mount Vernon; Bellingham Baking Company, 2001 State Street, Bellingham; City Bakery, 607 1st Street, Mount Vernon; Thrifty Foods, 130 Fairhaven Avenue, Burlington; Golden Rule

Bakery, Inc., 915 Center Street, Tacoma; Jordan Baking Company, 3623 S. 54th Street, Tacoma; Eddy Bakeries Company, Inc., 232 S. Front Street, Yakima; Sigman Food Stores, P.O. Box 618, Yakima; and the following officials of Bakers of Washington, Inc.: Miss Maud Pemberton, Golden Rule Bakery, Inc., 4450 Fremont Avenue, Seattle; Henry Richards, Continental Baking Company, P.O. Box 3227, Seattle; Lloyd C. Mitchell, Van de Kamp's Holland Dutch Bakers, 823 Yale Avenue, North, Seattle; Lou Blackfield, Bake-Rite Bakery, 1414 14th Avenue, Seattle; Horace Snyder, Snyder's Bakery, Inc., 31 North 4th Street, Yakima; Al Moore, Langendorf United Bakeries, Inc., 2901 6th Avenue, South, Seattle; Roy Reynolds, Grandma Cookie Baking Co., Inc., 3402 Wallingford, Seattle; LeConie Stiles, Jr., Ruth Ashbrook Bakeries Corp., 1407 11th Avenue, Seattle; Hentry Gal, Seattle French Baking Co., Inc., 2006 Weller Street, Seattle; Donald R. Due, Best Pie Company, Inc., 132 Queen Anne Avenue, Seattle; and Maurice Vyvey, Baker Boy Bakery, 8050 Bothell Way, Seattle, as officers of Bakers of Washington, Inc.; and respondents Safeway Stores, Inc., and Holsum Baking Company, corporations; and respondents' representatives, agents and employees, directly or through any corporate or other device in or in connection with the offering for sale, sale or distribution of bread, do forthwith cease and desist from:

Entering into, carrying out, continuing or cooperating in any planned common course of action, understanding, agreement, combination or conspiracy between or among any two or more of said respondents, or members of Bakers of Washington, Inc., or between any one or more of them and others not parties hereto, where any one or more of the parties to such planned common course of action, understanding, agreement, combination or conspiracy is selling bread in interstate commerce in competition with bread sold by any one or more of the other parties thereto, to do or perform any of the following things:

- (1) Establish, fix or maintain prices, terms or conditions of sale of bread.
- (2) Adhere to any prices, terms or conditions of sale so fixed or maintained, or
- (3) Deter or attempt to deter any competitor from exercising his individual judgment as to prices, terms or conditions of sale of bread.

It is further ordered, That the complaint herein be, and the same hereby is, dismissed as to Arthur H. LaLime, deceased.

It is further ordered, That respondents shall, within sixty (60) days after service upon them of this order, file with the Commission a report, in writing, setting forth in detail the manner and form in which they have complied with the order set forth herein.

Issued: February 28, 1964.

[SEAL] JOSEPH W. SHEA,
Secretary.

[F.R. Doc. 64-3596; Filed, Apr. 13, 1964; 8:45 a.m.]

PART 14—ADMINISTRATIVE INTERPRETATIONS

Tire Advertising Guides

The Federal Trade Commission has amended paragraph (j) *Prices of \$14.3 Tire advertising guides* of this part to read as follows:

§ 14.3 Tire advertising guides.

(j) *Deceptive pricing.* Members of the industry shall not represent directly or indirectly in advertising or otherwise that an industry product may be purchased for a specified price, or at a saving, or at a reduced price, when such is not the fact; or otherwise deceive purchasers or prospective purchasers with respect to the price of any product offered for sale; or furnish any means or instrumentality by which others engaged in the sale of industry products may make any such representation.

NOTE: On December 20, 1963 the Commission adopted Guides Against Deceptive Pricing which became effective on January 8, 1964 and which supersede paragraph (j) of § 14.3 as adopted May 20, 1958. Copies of the 1964 Guides will be furnished upon request.

The reason for the amendment is self-evident in the above Note.

(Sec. 5, 38 Stat. 719, as amended; 15 U.S.C. 45)

Approved: April 3, 1964.

By direction of the Commission.

[SEAL] JOSEPH W. SHEA,
Secretary.

[F.R. Doc. 64-3586; Filed, Apr. 13, 1964; 8:45 a.m.]

Title 21—FOOD AND DRUGS

Chapter I—Food and Drug Administration, Department of Health, Education, and Welfare

SUBCHAPTER B—FOOD AND FOOD PRODUCTS

PART 121—FOOD ADDITIVES

Subpart D—Food Additives Permitted in Food for Human Consumption

LACTYLIC ESTERS OF FATTY ACIDS

Correction

In F.R. Doc. 64-3520, appearing at page 4997 of the issue for Friday, April 10, 1964, § 121.1048(a) should open with the words "They are prepared * * *" instead of with the words "They were prepared * * *".

SUBCHAPTER C—DRUGS

PART 146b—CERTIFICATION OF STREPTOMYCIN (OR DIHYDRO-STREPTOMYCIN) AND STREPTOMYCIN- (OR DIHYDROSTREPTOMYCIN-) CONTAINING DRUGS

Streptomycin Hydrochloride Solution Oral Veterinary Etc.; Change in Expiration Date

Under the authority vested in the Secretary of Health, Education, and Wel-

fare by the Federal Food, Drug, and Cosmetic Act (sec. 507, 59 Stat. 463 as amended; 21 U.S.C. 357) and delegated to the Commissioner of Food and Drugs by the Secretary (21 CFR 2.90; 29 F.R. 471), the regulations for the certification of antibiotic and antibiotic-containing drugs (21 CFR 146b.119) are amended as follows:

Section 146b.119 is amended by changing the expiration dates in paragraphs (c) (3) and (f) (1). As amended the affected portions read as follows:

§ 146b.119 Streptomycin hydrochloride solution oral veterinary; streptomycin sulfate solution oral veterinary.

(c) * * *

(3) The statement "Expiration date _____," the blank being filled in with the date that is 12 months after the month during which the batch was certified, except that the blank may be filled in with the date that is 18 months or 24 months after the month during which the batch was certified if the person who requests certification has submitted to the Commissioner results of tests and assays showing that after having been stored for such period of time, such drug as prepared by him complies with the standards prescribed by paragraph (a) of this section.

(f) * * *

(1) The labels bear an expiration date that is not more than 24 months after the month during which the batch was last assayed and released by the manufacturer.

Notice and public procedure are not necessary prerequisites to the promulgation of this order, and I so find, since the nature of the changes is such that they cannot be applied to any specific product unless and until the manufacturer thereof has supplied adequate data regarding that article.

Effective date. This order shall be effective on the date of its publication in the FEDERAL REGISTER.

(Sec. 507, 59 Stat. 463 as amended; 21 U.S.C. 357)

Dated: April 8, 1964.

GEO. P. LARRICK,
Commissioner of Food and Drugs.

[F.R. Doc. 64-3631; Filed, Apr. 13, 1964;
8:48 a.m.]

Title 26—INTERNAL REVENUE

Chapter I—Internal Revenue Service, Department of the Treasury

SUBCHAPTER A—INCOME TAX

[T.D. 6722]

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Miscellaneous Amendments

On September 17, 1963, notice of proposed rule making with respect to the

amendment of the Income Tax Regulations (26 CFR Part 1) under sections 37, 62, 72, 101, 104, 105, 401, 402, 403, 404, 503, and 1361 of the Internal Revenue Code of 1954 (relating to the inclusion of certain medical benefits in pension or annuity plans, to the prohibited transactions of trusts under certain plans covering owner-employees, and certain other miscellaneous matter) to conform to section 2 (a) and (b) of the Act of October 23, 1962 (Public Law 87-863, 76 Stat. 1141) and sections 6 and 7 (a)-(e) and (h) of the Self-Employed Individuals Tax Retirement Act of 1962 (76 Stat. 828, 829) was published in the FEDERAL REGISTER (28 F.R. 10161). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendment of the regulations as proposed is hereby adopted, subject to the changes set forth below. In addition, there is contained herein an amendment of the Income Tax Regulations under section 6033 of the Internal Revenue Code of 1954 which modifies the information required to be filed with the return of an exempt employees' trust.

PARAGRAPH 1. Paragraph (h) of § 1.72-15 is amended.

PAR. 2. Paragraph (b) of § 1.105-5 is amended.

PAR. 3. Paragraph (b) (1) (i) of § 1.401-1 is amended.

PAR. 4. Paragraph (b) of § 1.404-14 is amended.

PAR. 5. Paragraph (f) (2) (i) of § 1.404 (a)-3 is amended.

PAR. 6. Paragraph (a) (3) of § 1.6033-1 is amended.

[SEAL] MORTIMER M. CAPLIN,
Commissioner of Internal Revenue.

Approved: April 8, 1964.

STANLEY S. SURREY,
Assistant Secretary of the
Treasury.

PARAGRAPH 1. Section 1.37 is amended by revising section 37(c) (1) and by changing the historical note. These amended provisions read as follows:

§ 1.37 Statutory provisions; retirement income.

SEC. 37. Retirement income. * * *

(c) Retirement income. * * *

(1) In the case of an individual who has attained the age of 65 before the close of the taxable year, income from—

(A) Pensions and annuities (including, in the case of an individual who is, or has been, an employee within the meaning of section 401(c) (1), distributions by a trust described in section 401(a) which is exempt from tax under section 501(a)),

(B) Interest,

(C) Rents,

(D) Dividends, and

(E) Bonds described in section 405(b) (1) which are received under a qualified bond purchase plan described in section 405(a) or in a distribution from a trust described in section 401(a) which is exempt from tax under section 501(a), or

[Sec. 37 as amended by Act of Aug. 9, 1955 (Pub. Law 299, 84th Cong., 69 Stat. 591); Act of Jan. 28, 1956 (Pub. Law 398, 84th Cong., 70 Stat. 8); Act of Oct. 24, 1962 (Pub. Law 87-876, 76 Stat. 1199); sec. 7(a), Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 828)]

PAR. 2. Section 1.37-3 is amended by revising paragraph (a) (2) to read as follows:

§ 1.37-3 Retirement income.

(a) Inclusions in retirement income.

(2) Individuals 65 or over at the close of taxable year. In the case of individuals who have attained the age of 65 before the close of the taxable year, retirement income consists of income from pensions and annuities, interest, rents, dividends, and bonds described in section 405(b) (1) which are received under a qualified bond purchase plan described in section 405(a) or in a distribution from a trust described in section 401(a) which is exempt from tax under section 501(a), to the extent that such income is includible in gross income. Pensions and annuities include (but are not limited to) amounts received as such under a public retirement system or under a retirement system established for members of the Armed Forces of the United States and distributions which are made by a trust described in section 401(a) and exempt from tax under section 501(a) and which are attributable to contributions on behalf of a self-employed individual. For the purpose of section 37(c) (1), income from rents shall be the gross amount received, not reduced by depreciation or other expenses. Retirement income does not include royalties as distinguished from rents.

PAR. 3. Section 1.62 is amended by adding a new paragraph (7) to section 62 and by adding a historical note. These added provisions read as follows:

§ 1.62 Statutory provisions; adjusted gross income defined.

SEC. 62. Adjusted gross income defined.

(7) Pension, profit-sharing, annuity, and bond purchase plans of self-employed individuals. In the case of an individual who is an employee within the meaning of section 401(c) (1), the deductions allowed by section 404 and section 405(c) to the extent attributable to contributions made on behalf of such individual.

[Sec. 62 as amended by sec. 7(b), Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 828)]

PAR. 4. Section 1.62-1 is amended by revising paragraph (c) (8) and (9) and by adding a new subparagraph to paragraph (c). These amended and added provisions read as follows:

§ 1.62-1 Adjusted gross income.

(c) * * *

(8) Deductions allowable under part VI, section 212, and section 611 which are attributable to property held for the production of rents or royalties;

(9) Deductions for depreciation and depletion allowable under sections 167 and 611 to a life tenant of property or to an income beneficiary of property held in trust or to an heir, legatee, or devisee of an estate;

(10) Deductions allowed by sections 404 and 405(c) for contributions on behalf of a self-employed individual.

PAR. 5. There is added immediately after paragraph (g) of § 1.72-15 the following new paragraph:

§ 1.72-15 Applicability of section 72 to accident or health plans.

(h) *Medical benefits for retired employees, etc.* Employer contributions to provide medical benefits described in section 401(h) under a qualified pension or annuity plan are not includible in the gross income of the employee on whose behalf such contributions were made. Similarly, if the trustee of a trust forming a part of a qualified pension plan applies employer contributions which have been contributed to provide medical benefits described in section 401(h) or earnings thereon, to purchase insurance contracts which provide such benefits, the amount so applied is not includible in the gross income of the employee on whose behalf such insurance was purchased. The payment of medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14 under a plan established by an employer shall be treated in the same manner as the payment of any other accident or health benefits under an employer-established plan. See paragraphs (b), (c), and (d) of this section.

PAR. 6. Paragraph (b) (1) of § 1.72-18 is amended by adding a new subdivision (vii) at the end thereof. The added provision reads as follows:

§ 1.72-18 Treatment of certain total distributions with respect to self-employed individuals.

(b) *Distributions to which this section applies.* (1) * * *

(vii) For purposes of this section, the total amounts payable to a distributee or payee, or the amounts to the credit of the employee, do not include any amounts which have been placed in a separate account for the funding of medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14. Thus, a distribution by a qualified trust or annuity plan may constitute a distribution to which this section applies even though amounts attributable to the funding of section 401(h) medical benefits as defined in paragraph (a) of § 1.401-14 are not so distributed.

PAR. 7. Section 1.101 is amended by revising section 101(b) (2) (B), by adding a paragraph (3) to section 101(b), and by adding a historical note. These amended and added provisions read as follows:

§ 1.101 Statutory provisions; certain death benefits.

Sec. 101. Certain death benefits. * * *

(b) *Employees' death benefits.* * * *

(2) *Special rules for paragraph (1).* * * *

(B) *Nonforfeitable rights.* Paragraph (1) shall not apply to amounts with respect to which the employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living. This subparagraph shall not apply to total distributions payable (as defined in section 402(a) (3)) which are paid to a distributee within one taxable year of the distributee by reason of the employee's death—

(i) By a stock bonus, pension, or profit-sharing trust described in section 401(a) which is exempt from tax under section 501(a),

(ii) Under an annuity contract under a plan described in section 403(a), or

(iii) Under an annuity contract purchased by an employer which is an organization referred to in section 503(b) (1), (2), or (3) and which is exempt from tax under section 501(a), but only with respect to that portion of such total distributions payable which bears the same ratio to the amount of such total distributions payable which is (without regard to this subsection) includible in gross income, as the amounts contributed by the employer for such annuity contract which are excludable from gross income under section 403(b) bear to the total amounts contributed by the employer for such annuity contract.

(3) *Self-employed individual not considered an employee.* For purposes of this subsection, the term "employee" does not include an individual who is an employee within the meaning of section 401(c) (1) (relating to self-employed individuals).

[Sec. 101 as amended by sec. 23(d), Technical Amendments Act 1958 (72 Stat. 1622); sec. 7(c), Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 829)]

PAR. 8. Section 1.101-2 is amended by adding the following new paragraph:

§ 1.101-2 Employees' death benefits.

(f) *Distributions on behalf of a self-employed individual.* (1) Under sections 401(c) (1) and 403(a) (3), certain self-employed individuals may be covered by a pension or profit-sharing plan described in section 401(a) and exempt under section 501(a) or under an annuity plan described in section 403(a). However, a payment pursuant to the provisions of any such plan by reason of the death of an individual who participated in such a plan as a self-employed individual immediately before his retirement or death to the beneficiary or estate of such individual does not qualify for the exclusion provided by section 101(b).

(2) The application of this paragraph may be illustrated by the following examples:

Example (1). From 1950 to 1965, A was an employee of B, a sole proprietor. In 1963, B established a qualified pension plan covering A and all other persons who had been employed by B for more than 3 years. In 1965, A acquired from B a 40-percent interest in the capital and profits of the business. A continued to participate in the pension plan as a self-employed individual. In 1970, A died and his widow, in compliance with one of the provisions of the pension plan, elected to receive all of the benefits accrued to A prior to his death in a lump-sum distribution. As A participated in the plan as a self-employed individual immediately prior to his death, A's widow may not exclude any portion of such distribution from her gross income under section 101(b).

Example (2). A, an attorney, is employed by the X Company in their legal department. He is covered by the pension plan that X has established for its employees. Under the terms of A's contract of employment with X, A is permitted to carry on the private practice of law in his off-duty hours. A establishes his own pension plan with respect to his earnings from his private practice. On A's death, his widow elected to receive a lump-sum distribution with respect to any benefits accrued to A under both X's pension plan and A's own pension plan. To the extent that such payment otherwise complies with the requirements of section

101(b), up to \$5,000 of the amount paid by X may be excluded from her gross income. No part of the distribution from A's own pension plan may be excluded from her gross income under section 101(b) because A participated in the plan as a self-employed individual immediately before his death.

PAR. 9. Section 1.104 is amended by revising section 104(a) to add a new sentence after paragraph (4) and by adding a historical note. These added provisions read as follows:

§ 1.104 Statutory provisions; compensation for injuries or sickness.

Sec. 104. Compensation for injuries or sickness—(a) *In general.* * * *

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c) (1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee.

[Sec. 104 as amended by sec. 7(d), Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 829)]

PAR. 10. Section 1.104-1 is amended by revising paragraph (d) to read as follows:

§ 1.104-1 Compensation for injuries or sickness.

(d) *Accident or health insurance.* Section 104(a) (3) excludes from gross income amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent that such amounts (1) are attributable to contributions of the employer which were not includible in the gross income of the employee, or (2) are paid by the employer). Similar treatment is also accorded to amounts received under accident or health plans and amounts received from sickness or disability funds. See section 105(e) and § 1.105-5. If, therefore, an individual purchases a policy accident or health insurance out of his own funds, amounts received thereunder for personal injuries or sickness are excludable from his gross income under section 104(a) (3). See, however, section 213 and the regulations thereunder as to the inclusion in gross income of amounts attributable to deductions allowed under section 213 for any prior taxable year. Section 104(a) (3) also applies to amounts received by an employee for personal injuries or sickness from a fund which is maintained exclusively by employee contributions. Conversely, if an employer is either the sole contributor to such a fund, or is the sole purchaser of a policy of accident or health insurance for his employees (on either a group or individual basis), the exclusion provided under section 104(a) (3) does not apply to any amounts received by his employees through such fund or insurance. If the employer and his employees contribute to a fund or purchase insurance which pays accident or health benefits to employees, section

104(a)(3) does not apply to amounts received thereunder by employees to the extent that such amounts are attributable to the employer's contributions. See § 1.105-1 for rules relating to the determination of the amount attributable to employer contributions. Although amounts paid by or on behalf of an employer to an employee for personal injuries or sickness are not excludable from the employee's gross income under section 104(a)(3), they may be excludable therefrom under section 105. See §§ 1.105-1 through 1.105-5, inclusive. For treatment of accident or health benefits paid to or on behalf of a self-employed individual by a trust described in section 401(a) which is exempt under section 501(a) or under a plan described in section 403(a), see paragraph (g) of § 1.72-15.

PAR. 11. Section 1.105 is amended by adding a new subsection (g) to section 105 and by adding a historical note. These added provisions read as follows:

§ 1.105 Statutory provisions; amounts received under accident and health plans.

SEC. 105. Amounts received under accident and health plans. * * *

(g) Self-employed individual not considered an employee. For purposes of this section, the term "employee" does not include an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals).

[Sec. 105 as amended by sec. 7(e), Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 829)]

PAR. 12. Section 1.105-1 is amended by revising paragraph (a) to read as follows:

§ 1.105-1 Amounts attributable to employer contributions.

(a) In general. Under section 105(a), amounts received by an employee through accident or health insurance for personal injuries or sickness must be included in his gross income to the extent that such amounts (1) are attributable to contributions of the employer which were not includible in the gross income of the employee, or (2) are paid by the employer, unless such amounts are excluded therefrom under section 105 (b), (c), or (d). For purposes of this section, the term "amounts received by an employee through an accident or health plan" refers to any amounts received through accident or health insurance, and also to any amounts which, under section 105(e), are treated as being so received. See § 1.105-5. In determining the extent to which amounts received for personal injuries or sickness by an employee through an accident or health plan are subject to the provisions of section 105(a), rather than section 104(a)(3), the provisions of paragraphs (b), (c), (d), and (e) of this section shall apply. A self-employed individual is not an employee for purposes of section 105 and §§ 1.105-1 through 1.105-5. See paragraph (g) of § 1.72-15. Thus, such an individual will not be treated as an employee with respect to benefits described in section 105 received from a plan in which he participates as an employee within the meaning of section

401(c)(1) at the time he, his spouse, or any of his dependents becomes entitled to receive such benefits.

PAR. 13. Section 1.105-5 is amended to read as follows:

§ 1.105-5 Accident and health plans.

(a) In general. Sections 104(a)(3) and 105 (b), (c), and (d) exclude from gross income certain amounts received through accident or health insurance. Section 105(e) provides that for purposes of sections 104 and 105 amounts received through an accident or health plan for employees, and amounts received from a sickness and disability fund for employees maintained under the law of a State, a Territory, or the District of Columbia, shall be treated as amounts received through accident or health insurance. In general, an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness. A plan may cover one or more employees, and there may be different plans for different employees or classes of employees. An accident or health plan may be either insured or noninsured, and it is not necessary that the plan be in writing or that the employee's rights to benefits under the plan be enforceable. However, if the employee's rights are not enforceable, an amount will be deemed to be received under a plan only if, on the date the employee became sick or injured, the employee was covered by a plan (or a program, policy, or custom having the effect of a plan) providing for the payment of amounts to the employee in the event of personal injuries or sickness, and notice or knowledge of such plan was reasonably available to the employee. It is immaterial who makes payment of the benefits provided by the plan. For example, payment may be made by the employer, a welfare fund, a State sickness or disability benefits fund, an association of employers or employees, or by an insurance company.

(b) Self-employed individuals. Under section 105(g), a self-employed individual is not treated as an employee for purposes of section 105. Therefore, for example, benefits paid under an accident or health plan as referred to in section 105(e) to or on behalf of an individual who is self-employed in the business with respect to which the plan is established will not be treated as received through accident and health insurance for purposes of sections 104(a)(3) and 105.

PAR. 14. Section 1.401 is amended by redesignating subsection (h) of section 401 as subsection (i), by inserting after subsection (g) a new subsection (h), and by amending the historical note. These amended and added provisions read as follows:

§ 1.401 Statutory provisions; qualified pension, profit-sharing, and stock bonus plans.

SEC. 401. Qualified pension, profit-sharing, and stock bonus plans. * * *

(h) Medical, etc., benefits for retired employees and their spouses and dependents. Under regulations prescribed by the Secretary or his delegate, a pension or annuity plan may provide for the payment of benefits

for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and their dependents, but only if—

(1) Such benefits are subordinate to the retirement benefits provided by the plan,

(2) A separate account is established and maintained for such benefits,

(3) The employer's contributions to such separate account are reasonable and ascertainable,

(4) It is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits, and

(5) Notwithstanding the provisions of subsection (a)(2), upon the satisfaction of all liabilities under the plan to provide such benefits, any amount remaining in such separate account must, under the terms of the plan, be returned to the employer.

(i) Cross reference. For exemption from tax of a trust qualified under this section, see section 501(a).

[Sec. 401 as amended by sec. 2, Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 809); sec. 2(a), Act of Oct. 23, 1962 (Pub. Law 87-863, 76 Stat. 1141)]

PAR. 15. Paragraph (b)(1)(i) of § 1.401-1 is amended to read as follows:

§ 1.401-1 Qualified pension, profit-sharing, and stock bonus plans.

(b) General rules. (1)(i) A pension plan within the meaning of section 401 (a) is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. Retirement benefits generally are measured by, and based on, such factors as years of service and compensation received by the employees. The determination of the amount of retirement benefits and the contributions to provide such benefits are not dependent upon profits. Benefits are not definitely determinable if funds arising from forfeitures on termination of service, or other reason, may be used to provide increased benefits for the remaining participants (see § 1.401-7, relating to the treatment of forfeitures under a qualified pension plan). A plan designed to provide benefits for employees or their beneficiaries to be paid upon retirement or over a period of years after retirement will, for the purposes of section 401(a), be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits, or, as in the case of money purchase pension plans, such contributions are fixed without being geared to profits. A pension plan may provide for the payment of a pension due to disability and may also provide for the payment of incidental death benefits through insurance or otherwise. However, a plan is not a pension plan if it provides for the payment of benefits not customarily included in a pension plan such as layoff benefits or benefits for sickness, accident, hospitalization, or medical expenses (except medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14).

PAR. 16. Paragraph (a) (1) of § 1.401-2 is amended to read as follows:

§ 1.401-2 Impossibility of diversion under the trust instrument.

(a) *In general.* (1) Under section 401(a) (2) a trust is not qualified unless under the trust instrument it is impossible (in the taxable year and at any time thereafter before the satisfaction of all liabilities to employees or their beneficiaries covered by the trust) for any part of the trust corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of such employees or their beneficiaries. This section does not apply to funds of the trust which are allocated to provide medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14. For the rules prohibiting diversion of such funds and the requirement of reversion to the employer after satisfaction of all liabilities under the medical benefits account, see paragraph (c) (4) and (5) of § 1.401-14.

PAR. 17. There is inserted immediately after § 1.401-13 the following new section:

§ 1.401-14 Inclusion of medical benefits for retired employees in qualified pension or annuity plans.

(a) *Introduction.* Under section 401(h) a qualified pension or annuity plan may make provision for the payment of sickness, accident, hospitalization, and medical expenses for retired employees, their spouses, and their dependents. The term "medical benefits described in section 401(h)" is used in this section to describe such payments.

(b) *In general—(1) Coverage.* Under section 401(h), a qualified pension or annuity plan may provide for the payment of medical benefits described in section 401(h) only for retired employees, their spouses, or their dependents. To be "retired" for purposes of eligibility to receive medical benefits described in section 401(h), an employee must be eligible to receive retirement benefits provided under the pension plan, or else be retired by an employer providing such medical benefits by reason of permanent disability. For purposes of the preceding sentence, an employee is not considered to be eligible to receive retirement benefits provided under the plan if he is still employed by the employer and a separation from employment is a condition to receiving the retirement benefits.

(2) *Discrimination.* A plan which provides medical benefits described in section 401(h) must not discriminate in favor of officers, shareholders, supervisory employees, or highly compensated employees with respect to coverage and with respect to the contributions or benefits under the plan. The determination of whether such a plan so discriminates is made with reference to the retirement portion of the plan as well as the portion providing the medical benefits described in section 401(h). Thus, for example, a plan will not be qualified under section 401 if it discriminates in favor of employees who are officers or shareholders with respect to either portion of the plan.

(3) *Funding medical benefits.* Contributions to provide the medical benefits described in section 401(h) may be made either on a contributory or non-contributory basis, without regard to whether the contributions to fund the retirement benefits are made on a similar basis. Thus, for example, the contributions to fund the medical benefits described in section 401(h) may be provided for entirely out of employer contributions even though the retirement benefits under the plan are determined on the basis of both employer and employee contributions.

(4) *Definitions.* For purposes of section 401(h) and this section:

(i) The term "dependent" shall have the same meaning as that assigned to it by section 152, and

(ii) The term "medical expense" means expenses for medical care as defined in section 213(e) (1).

(c) *Requirements.* The requirements which must be met for a qualified pension or annuity plan to provide medical benefits described in section 401(h) are set forth in subparagraphs (1) through (5) of this paragraph.

(1) *Benefits.* (i) The plan must specify the medical benefits described in section 401(h) which will be available and must contain provisions for determining the amount which will be paid. Such benefits, when added to any life insurance protection provided for under the plan, must be subordinate to the retirement benefits provided by such plan. For purposes of this section, life insurance protection includes any benefit paid under the plan on behalf of an employee-participant as a result of the employee-participant's death to the extent such payment exceeds the amount of the reserve to provide the retirement benefits for the employee-participant existing at his death. The medical benefits described in section 401(h) are considered subordinate to the retirement benefits if at all times the aggregate of contributions (made after the date on which the plan first includes such medical benefits) to provide such medical benefits and any life insurance protection does not exceed 25 percent of the aggregate contributions (made after such date) other than contributions to fund past service credits.

(ii) The meaning of the term "subordinate" may be illustrated by the following example:

Example. The X Corporation amends its qualified pension plan to provide medical benefits described in section 401(h) effective for the taxable year 1964. The total contributions under the plan (excluding those for past service credits) for the taxable year 1964 are \$125,000, allocated as follows: \$100,000 for retirement benefits, \$10,000 for life insurance protection, and \$15,000 for medical benefits described in section 401(h). The medical benefits described in section 401(h) are considered subordinate to the retirement benefits since the portion of the contributions allocated to the medical benefits described in section 401(h) (\$15,000) and to life insurance protection after such medical benefits were included in the plan (\$10,000), or \$25,000, does not exceed 25 percent of \$125,000. For the taxable year 1965,

the X Corporation contributes \$140,000 (exclusive of contributions for past service credits) allocated as follows: \$100,000 for retirement benefits, \$10,000 for life insurance protection, and \$30,000 for medical benefits described in section 401(h). The medical benefits described in section 401(h) are considered subordinate to the retirement benefits since the aggregate contributions allocated to the medical benefits described in section 401(h) (\$45,000) and to life insurance protection after such medical benefits were included in the plan (\$20,000) or \$65,000 does not exceed 25 percent of \$265,000, the aggregate of the contributions made in 1964 and 1965.

(2) *Separate accounts.* Where medical benefits described in section 401(h) are provided for under a qualified pension or annuity plan, a separate account must be maintained with respect to contributions to fund such benefits. The separation required by this section is for recordkeeping purposes only. Consequently, the funds in the medical benefits account need not be separately invested. They may be invested with funds set aside for retirement purposes without identification of which investment properties are allocable to each account. However, where the investment properties are not allocated to each account, the earnings on such properties must be allocated to each account in a reasonable manner.

(3) *Reasonable and ascertainable.* Section 401(h) further requires that amounts contributed to fund medical benefits therein described must be reasonable and ascertainable. For the rules relating to the deduction of such contributions, see paragraph (f) of § 1.404(a)-3. The employer must, at the time he makes a contribution, designate that portion of such contribution allocable to the funding of medical benefits.

(4) *Impossibility of diversion prior to satisfaction of all liabilities.* Section 401(h) further requires that it must be impossible, at any time prior to the satisfaction of all liabilities under the plan to provide for the payment of medical benefits described in section 401(h), for any part of the corpus or income of the medical benefits account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits. Consequently, a plan which, for example, under its terms, permits funds in the medical benefits account to be used for any retirement benefit provided under the plan does not satisfy the requirements of section 401(h) and will not qualify under section 401(a). However, the payment of any necessary or appropriate expenses attributable to the administration of the medical benefits account does not affect the qualification of the plan.

(5) *Reversion upon satisfaction of all liabilities.* The plan must provide that any amounts which are contributed to fund medical benefits described in section 401(h) and which remain in the medical benefits account upon the satisfaction of all liabilities arising out of the operation of the medical benefits portion of the plan are to be returned to the employer.

(6) *Forfeitures.* The plan must expressly provide that in the event an in-

dividual's interest in the medical benefits account is forfeited prior to termination of the plan an amount equal to the amount of the forfeiture must be applied as soon as possible to reduce employer contributions to fund the medical benefits described in section 401(h).

(d) *Effective date.* This section applies to taxable years of a qualified pension or annuity plan beginning after October 23, 1962.

PAR. 18. Section 1.402(a)-1 is amended by adding a new subdivision (vi) at the end of paragraph (a) (1) and by adding a new subdivision (viii) at the end of paragraph (a) (6). These added provisions read as follows:

§ 1.402(a)-1 Taxability of beneficiary under a trust which meets the requirements of section 401(a).

(a) *In general.* (1) * * *

(vi) For the treatment of amounts paid to provide medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14, see paragraph (h) of § 1.72-15.

(6) * * *

(viii) The term "total distributions payable" does not include any amount which has been placed in a separate account for the funding of medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14. Thus, a distribution by a qualified trust may constitute a total distributions payable with respect to an employee even though the trust retains amounts attributable to the funding of medical benefits described in section 401(h).

PAR. 19. Section 1.403(a)-1 is amended by adding a new paragraph (g) at the end thereof. The added provision reads as follows:

§ 1.403(a)-1 Taxability of beneficiary under a qualified annuity plan.

(g) For the treatment of amounts paid to provide medical benefits described in section 401(h) as defined in § 1.401-14, see paragraph (h) of § 1.72-15.

PAR. 20. Section 1.403(a)-2 is amended by adding the following new subparagraph (6) to paragraph (b):

§ 1.403(a)-2 Capital gains treatment for certain distributions.

(6) * * *

(6) The term "total amounts" does not include any amount which has been placed in a separate account for the funding of benefits described in section 401(h). Thus, a distribution under a qualified annuity plan may constitute a distribution of the total amounts payable with respect to an employee even though amounts attributable to the funding of section 401(h) medical benefits as defined in paragraph (a) of § 1.401-14 are not so distributed.

PAR. 21. Section 1.404(a) is amended by revising section 404(a)(2) and by amending the historical note. These amended provisions read as follows:

§ 1.404(a) Statutory provisions; deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan; general rule.

SEC. 404. *Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan—(a) General rule.* * * *

(2) *Employees' annuities.* In the taxable year when paid, in an amount determined in accordance with paragraph (1), if the contributions are paid toward the purchase of retirement annuities, or retirement annuities and medical benefits as described in section 401(h), and such purchase is a part of a plan which meets the requirements of section 401(a) (3), (4), (5), (6), (7), and (8), and, if applicable, the requirements of section 401(a) (9) and (10) and of section 401(d) (other than paragraph (1)), and if refunds of premiums, if any, are applied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities, or such retirement annuities and medical benefits.

[Sec. 404(a) as amended by sec. 3, Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 819; sec. 2(b), Act of Oct. 23, 1962 (Pub. Law 87-863, 76 Stat. 1141)]

PAR. 22. Section 1.404(a)-3 is amended by revising paragraph (a) and by inserting after paragraph (e) a new paragraph (f). These amended and added provisions read as follows:

§ 1.404(a)-3 Contributions of an employer to or under an employees' pension trust or annuity plan that meets the requirements of section 401(a); application of section 404(a)(1).

(a) If contributions are paid by an employer to or under a pension trust or annuity plan for employees and the general conditions and limitations applicable to deductions for such contributions are satisfied (see § 1.404(a)-1), the contributions are deductible under section 404(a)(1) or (2) if the further conditions provided therein are also satisfied. As used in this section, a "pension trust" means a trust forming part of a pension plan and an "annuity plan" means a pension plan under which retirement benefits are provided under annuity or insurance contracts without a trust. This section is also applicable to contributions to a foreign situs pension trust which could qualify for exemption under section 501(a) except that it is not created or organized and maintained in the United States. For the meaning of "pension plan" as used in this section, see paragraph (b) (1) (i) of § 1.401-1. Where disability pensions, insurance, or survivorship benefits incidental and directly related to the retirement benefits under a pension or annuity plan are provided for the employees or their beneficiaries by contributions under the plan, deductions on account of such incidental benefits are also covered under section 404(a)(1) or (2). See paragraph (b) (2) of § 1.72-16 as to taxability to employees of cost of incidental life insurance protection. Similarly, where medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14 are provided for retired employees, their spouses, or their dependents under the plan, deduc-

tions on account of such subordinate benefits are also covered under section 404(a)(1) or (2). In order to be deductible under section 404(a)(1), contributions to a pension trust must be paid in a taxable year of the employer which ends with or within a year of the trust for which it is exempt under section 501(a). Contributions paid in such a taxable year of the employer may be carried over and deducted in a succeeding taxable year of the employer in accordance with section 404(a)(1)(D), whether or not such succeeding taxable year ends with or within a taxable year of the trust for which it is exempt under section 501(a). See § 1.404(a)-7 for rules relating to the limitation on the amount deductible in such a succeeding taxable year of the employer. See § 1.404(a)-8 as to conditions for deductions under section 404(a)(2) in the case of an annuity plan. In either case, the deductions are also subject to further limitations provided in section 404(a)(1). The limitations provided in section 404(a)(1) are, with an exception provided for certain years under subparagraph (A) thereof (see § 1.404(a)-4), based on the actuarial costs of the plan.

(f) (1) Amounts contributed by an employer under the plan for the funding of medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401-14 must satisfy the general requirements which are applicable to deductions allowable under section 404 and which are set forth in § 1.404(a)-1 including, for example, the requirements described in paragraph (b) of such section. Accordingly, such amounts must constitute an ordinary and necessary expense relating to either the trade or business or the production of income and must not, when added to all other compensation paid by the employer to the employee on whose behalf such a contribution is made, constitute more than reasonable compensation. However, in determining the amount which is deductible with respect to contributions to provide retirement benefits under the plan, amounts contributed for the funding of medical benefits described in section 401(h) shall not be taken into consideration.

(2) The amounts deductible with respect to employer contributions to fund medical benefits described in section 401(h) shall not exceed the total cost of providing such benefits. The total cost of providing such benefits shall be determined in accordance with any generally accepted actuarial method which is reasonable in view of the provisions and coverage of the plan, the funding medium, and other applicable considerations. The amount deductible for any taxable year with respect to such cost shall not exceed the greater of—

(i) An amount determined by distributing the remaining unfunded costs of past and current service credits as a level amount, or as a level percentage of compensation, over the remaining future service of each employee, or

(ii) 10 percent of the cost which would be required to completely fund or purchase such medical benefits.

In determining the amount deductible, an employer must apply either subdivision (i) of this subparagraph for all employees or subdivision (ii) of this subparagraph for all employees. If contributions paid by an employer in a taxable year to fund such medical benefits under a pension or annuity plan exceed the limitations of this subparagraph but otherwise satisfy the conditions for deduction under section 404, then the excess contributions are carried over and are deductible in succeeding taxable years of the employer which end with or within taxable years of the trust for which it is exempt under section 501(a) in order of time to the extent of the difference between the amount paid and deductible in each succeeding year and the limitation applicable to such year under this subparagraph. For purposes of subdivision (i) of this subparagraph, if the remaining future service of an employee is one year or less, it shall be treated as one year.

PAR. 23. Section 1.404(a)-8 is amended by revising paragraph (a) (1), by revising that portion of paragraph (a) (3) which precedes subdivision (i), and by adding a new sentence to paragraph (a) (3) after subdivision (ii) (b). These amended and added provisions read as follows:

§ 1.404(a)-8 Contributions of an employer under an employees' annuity plan which meets the requirements of section 401(a); application of section 404(a) (2).

(a) * * *

(1) The contributions must be paid toward the purchase of retirement annuities (or for disability, severance, insurance, survivorship benefits incidental and directly related to such annuities, or medical benefits described in section 401 (h) as defined in paragraph (a) of § 1.401-14) under an annuity plan for the exclusive benefit of the employer's employees or their beneficiaries. See paragraph (a) of § 1.401-1.

(3) There must be a definite written arrangement between the employer and the insurer that refunds of premiums, if any, shall be applied within the taxable year of the employer in which received or within the next succeeding taxable year toward the purchase of retirement annuities (or for disability, severance, insurance, survivorship benefits incidental and directly related to such annuities, or medical benefits described in section 401 (h) as defined in paragraph (a) of § 1.401-14) under the plan. For the purpose of this condition, "refunds of premiums" means payments by the insurer on account of credits such as dividends, experience rating credits, or surrender or cancellation credits. The arrangement may be in the form of contract provisions or written directions of the employer or partly in one form and partly in another. This condition will be considered satisfied where—

If the plan also includes medical benefits described in section 401 (h) as defined in paragraph (a) of § 1.401-14, any refund of premium attributable to such

benefits must, in accordance with these rules, be applied toward the purchase of medical benefits described in section 401 (h) as defined in paragraph (a) of § 1.401-14.

PAR. 24. Paragraphs (a) and (b) of § 1.503(a)-1 are amended to read as follows:

§ 1.503(a)-1 Denial of exemption to organizations engaged in prohibited transactions.

(a) The prohibited transactions enumerated in section 503 are in addition to and not in limitation of the restrictions contained in section 501(c) (3) and section 401(a). Even though an organization has not engaged in any of the prohibited transactions referred to in section 503, it still may not qualify for tax exemption in view of the general provisions of section 501(c) (3) and section 401(a). Thus, if a trustee or other fiduciary of the organization (whether or not he is also a creator of such organization) enters into a transaction with the organization, such transaction will be closely scrutinized in the light of the fiduciary principle requiring undivided loyalty to ascertain whether the organization is in fact being operated for the stated exempt purposes.

(b) An organization described in section 501(c) (3) which after July 1, 1950, has engaged in any prohibited transaction as defined in section 503(c), unless it is excepted by the provisions of section 503(b), and an organization described in section 401(a) which after March 1, 1954, has engaged in any prohibited transaction defined in section 503 shall not be exempt from taxation under section 501(a) for any taxable year subsequent to the taxable year in which there is mailed to it a notice in writing by the Commissioner that it has engaged in such prohibited transaction. Such notification by the Commissioner shall be by registered or certified mail to the last known address of the organization. However, notwithstanding the requirement of notification by the Commissioner, exemption shall be denied with respect to any taxable year if such organization during or prior to such taxable year commenced the prohibited transaction with the purpose of diverting income or corpus from its exempt purposes and such transaction involved a substantial part of the income or corpus of such organization. For the purpose of this section, the term "taxable year" means the established annual accounting period of the organization; or, if the organization has no such established annual accounting period, the "taxable year" of the organization means the calendar year.

PAR. 25. Paragraph (a) of § 1.503(c)-1 is amended to read as follows:

§ 1.503(c)-1 Prohibited transactions.

(a) *In general.* For purposes of this section, the term "prohibited transaction" includes any transaction described as such in section 503(c) engaged in by an organization described in section 501 (c) (3) or section 401(a), other than those organizations excepted by section

503(b). Whether a transaction is a prohibited transaction depends on the facts and circumstances of the particular case. This section denies tax-exempt status to those organizations described in sections 501(c) (3) and 401(a) which engage in certain transactions which inure to the private advantage of (1) the creator of such organization (if it is a trust); (2) any substantial contributor to the organization; (3) a member of the family (as defined in section 267(c) (4)) of an individual who is such creator of or such substantial contributor to such organization; or (4) a corporation controlled, as set forth in section 503(c), by such creator or substantial contributor.

PAR. 26. Section 1.503(g)-1 is amended to read as follows:

§ 1.503(g)-1 Cross references.

For provisions relating to loans described in section 503(c) (1) by a trust described in section 401(a), see § 1.503 (c)-1 and section 503 (h) and (i) and the regulations thereunder.

PAR. 27. The following new sections are added immediately after § 1.503 (i)-1:

§ 1.503(j) Statutory provisions; requirements for exemption; trusts benefiting certain owner-employees.

SEC. 503. Requirements for exemption.

(j) *Trusts benefiting certain owner-employees—*(1) *Prohibited transactions.* In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c) (3)) who control (within the meaning of section 401(d) (9) (B)) the trade or business with respect to which the plan is established, the term "prohibited transaction" also means any transaction in which such trust, directly or indirectly—

(A) Lends any part of the corpus or income of the trust to;

(B) Pays any compensation for personal services rendered to the trust to;

(C) Makes any part of its services available on a preferential basis to; or

(D) Acquires for the trust any property from, or sells any property to;

any person described in subsection (c) or to any such owner-employee, a member of the family (as defined in section 267(c) (4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(2) *Special rule for loans.* For purposes of the application of paragraph (1) (A), the following rules shall apply with respect to a loan made before the date of the enactment of this subsection which would be a prohibited transaction if made in a taxable year beginning after December 31, 1962:

(A) If any part of the loan is repayable prior to December 31, 1965, the renewal of such part of the loan for a period not extending beyond December 31, 1965, on the same terms, shall not be considered a prohibited transaction.

(B) If the loan is repayable on demand, the continuation of the loan beyond December 31, 1965, shall be considered a prohibited transaction.

[Sec. 503(j) as added by sec. 6, Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 827)]

§ 1.503(j)-1 Trusts benefiting certain owner-employees.

(a) *In general.* Section 503(j) defines the term "prohibited transaction" to include certain transactions in addition to the transactions enumerated in section 503(c) in the case of an employee's trust described in section 401(a) and exempt from tax under section 501(a) forming part of a plan that covers (within the meaning of paragraph (a) (2) of § 1.401-10) one or more owner-employees who control the trade or business with respect to which the plan has been established. In the case of such a trust, the term "prohibited transaction" includes any transaction in which the trust, directly or indirectly—

- (1) Lends any part of the corpus or income of the trust to;
 - (2) Pays any compensation for personal services rendered to the trust to;
 - (3) Makes any part of its services available on a preferential basis to;
 - (4) Acquires for the trust any property from, or sells any property to;
- any person described in section 503(c) or to any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation. Mere participation by such a trust in such a transaction constitutes a "prohibited transaction" without regard to the reasonableness of the rate of either interest or compensation (as the case may be), the adequacy of the security involved, or the accuracy of the values the parties may have placed upon property which has been transferred to or from the trust.

(b) *Transfer of property to trust.* The term "prohibited transaction" as defined in section 503(j)(1)(D) includes any transaction in which a trust to which this section applies acquires property from, or sells property to, a person described in section 503(j). These persons include an owner-employee covered under the plan, of which the trust forms a part, and the person treated as the employer of such an owner-employee. For purposes of this section, a trust is considered to have "acquired" property when it is included in a contribution to the trust. Thus, in the case of a trust to which section 503(j) applies, the employer may not make a contribution of property to provide benefits for any employee, irrespective of whether such employee is a person described in section 503(j). Similarly, the owner-employee himself shall not contribute property to such a trust as an employee contribution permitted under the plan. For purposes of this section the term "property" does not include money. See also section 503(c) for transfers of property that constitute prohibited transactions.

(c) *Loans.* A loan made to a person described in section 503(j) by a trust after October 9, 1962, but prior to the date on which the plan, of which the trust forms a part, first covers an owner-

employee who controls, or owner-employees who together control, the trade or business with respect to which the plan is established is a prohibited transaction within the meaning of section 503(j) unless the loan is repaid prior to such date. For loans made before October 10, 1962, see section 503(j)(2).

(d) *Definitions.* For purposes of section 503(j) and this section:

(1) The term "owner-employee" has the same meaning as that assigned to it by section 401(c)(3) and paragraph (d) of § 1.401-10;

(2) The term "control" has the same meaning as that assigned to it by section 401(d)(9)(B) and paragraph (e)(3) of § 1.401-12.

(e) *Examples.* The following examples illustrate the application of section 503(j)(1):

Example (1). A, B, C, and D each owns a 25-percent interest in both the capital and profits of the ABCD Partnership engaged in a business with respect to which capital is not a material income-producing factor. The partnership has three full-time employees, E, F, and G. In 1963, the partnership established a qualified pension plan which covered all partners and full-time employees. In 1970, the trust, which was part of such plan, loaned partner A \$100,000 for which A gave him secured promissory note at the rate of 6 percent interest, the rate charged by financial institutions in the community where the transaction took place. The loan by the trust to A is a prohibited transaction since section 503(j)(1)(A) prohibits any loan to A, regardless of the rate of interest or the adequacy of the security.

Example (2). Assume the same facts as those given in example (1), with the exception of the loan to A. A's brother L, who is a specialist on the subject of employee benefit programs, was employed by the trust to render advice in connection with the administration of the trust. L was reasonably compensated by the trust for this work. However, since L is a member of A's family (as defined in section 267(c)(4)), the payment of this compensation to him for services rendered the pension trust constitutes a prohibited transaction within the meaning of section 503(j)(1)(B).

Example (3). Assume the same facts as those given in example (1), with the exception of the loan to A. The plan provided that each covered person could make voluntary employee contributions not to exceed five percent of his compensation. A contributed securities having a fair market value of \$2,500. A's contribution of securities constitutes a transaction in which the trust acquired property from a person described in section 503(j) and, therefore, was a prohibited transaction within the meaning of section 503(j)(1)(D).

Example (4). The ABC Partnership is composed of 10 partners. A, B, and C each owns a 15-percent interest in the profits and capital of the partnership. The remaining 55 percent is divided equally among the other partners. The partnership established a qualified pension plan under which all partners participate. The trust which was part of such plan, loaned partner A \$100,000 for which A gave him secured promissory note at the rate of 3 percent interest. Since there is no owner-employee, or combination of owner-employees, who control the business with respect to which the plan was established and who are covered under the plan, section 503(j) is not applicable to this situation. However, the loan may be a prohibited transaction within the meaning of section 503(c)(1).

PAR. 28. Section 1.1361 is amended by revising section 1361(d) and by adding a

historical note. These amended and added provisions read as follows:

§ 1.1361 Statutory provisions; unincorporated business enterprises electing to be taxed as domestic corporations.

SEC. 1361. *Unincorporated business enterprises electing to be taxed as domestic corporations.* * * *

(d) *Limitation.* A partner or proprietor of an unincorporated business enterprise as to which an election has been made under subsection (a) shall not be considered an employee for purposes of section 401(a) (relating to employees' pension trusts, etc.) other than an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), or for purposes of section 405 (relating to qualified bond purchase plans) other than an employee described in section 405(f).

[Sec. 1361 as amended by sec. 7(h), Self-Employed Individuals Tax Retirement Act 1962 (76 Stat. 829)]

PAR. 29. Section 1.1361-4 is amended to read as follows:

§ 1.1361-4 Pension or profit-sharing plan.

A proprietor or partner of a section 1361 corporation shall not be considered a common-law employee for purposes of section 401(a) (relating to employees' pension trusts, etc.), section 403(a) (relating to employees' annuity plans, etc.), or section 405 (relating to qualified bond purchase plans). Accordingly, such a proprietor or partner may not participate as a common-law employee in any pension or profit-sharing plan described in section 401(a), an annuity plan described in section 403(a), or a qualified bond purchase plan described in section 405 which the section 1361 corporation may have for its employees. However, such a proprietor or partner may participate in any such plan as a self-employed individual in accordance with those provisions of sections 401 through 405 which are applicable to self-employed individuals. A contribution to any such plan by a section 1361 corporation on behalf of a self-employed individual is deductible in computing the taxable income of such corporation. However, the amount of such deduction shall be determined in accordance with the provisions of section 404(a)(8), (9), (10), and (e). No deduction with respect to such contribution is allowable to the self-employed individual on whose behalf such contribution is made. For purposes of applying the provisions of sections 401-405 which are applicable to self-employed individuals, the proprietor or partner of a section 1361 corporation shall not be treated as a shareholder of such corporation.

PAR. 30. Paragraph (a)(3) of § 1.6033-1 is amended to read as follows:

§ 1.6033-1 Returns by exempt organizations.

(a) *In general.* * * *
(3) Every employees' trust described in section 401(a) which is exempt from taxation under section 501(a) shall file an annual return on Form 990-P. The return shall include the information required by paragraph (b)(5)(ii) of § 1.401-1. In addition, the trust must

file the information required to be filed by the employer pursuant to the provisions of § 1.404(a)-2, unless the employer has notified the trustee in writing that he has or will timely file such information. If the trustee has received such notification from the employer, then such notification, or a copy thereof, shall be retained by the trust as a part of its records.

Because the amendment in paragraph 30 to the regulations under section 6033 of the Internal Revenue Code of 1954 eliminates the requirement that certain documents be filed with the annual return of exempt employees' trusts, it is found that it is unnecessary to issue that portion of this Treasury decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

(Sec. 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805))

[F.R. Doc. 64-3657; Filed, Apr. 13, 1964; 8:49 a.m.]

Title 32—NATIONAL DEFENSE

Chapter VII—Department of the Air Force

PART 861—OFFICERS' RESERVE USAF OFFICER TRAINING SCHOOL (OTS)

PART 875—APPOINTMENT TO THE UNITED STATES AIR FORCE ACADEMY

PART 878—DECORATIONS AND AWARDS

Miscellaneous Amendments; Correction

1. In F.R. Doc. 65-3253 appearing in the issue for Friday, April 3, 1964, at page 4774, § 861.6(c) is corrected in its entirety, to read as follows:

§ 861.6 Eligibility requirements.

(c) *Educational qualifications.* (1) Applicants must be college graduates with a baccalaureate or higher degree from a college or university listed in the latest issue of Part 3, "Higher Education," Education Directory, published by the Department of Health, Education, and Welfare.

(2) An applicant who is a graduate of an unlisted or foreign college or university, if otherwise qualified, may meet the educational requirements by submitting evidence that the college's credits have been and are accepted as if coming from an accredited institution by not fewer than three U.S. accredited institutions.

(3) Students enrolled in the senior year of college may submit applications 210 days before scheduled graduation date. These persons will be processed as college graduates. Applicants will not be enlisted until documentary evidence has been submitted showing they have been awarded their degrees. This docu-

ment will be returned to the individual concerned and will not be part of his enlistment file.

§ 875.5 [Corrected]

2. In § 875.5(d) (1), line 2, "as affidavit" is corrected to read "an affidavit."

3. In § 878.44, paragraph (q) is corrected to read as follows:

§ 878.44 List of authorized service medals and ribbons.

(q) Small Arms Expert Marksmanship Ribbon.

By order of the Secretary of the Air Force.

WILLIAM L. KOCH,
Lt. Colonel, U.S. Air Force, Chief,
Special Activities Group, Office
of The Judge Advocate
General.

[F.R. Doc. 64-3607; Filed, Apr. 13, 1964; 8:46 a.m.]

Title 32A—NATIONAL DEFENSE, APPENDIX

Chapter I—Office of Emergency Planning

DMO I-17—FURTHER ASSIGNMENT OF DEFENSE MOBILIZATION AUTHORITY TO THE GENERAL SERVICES ADMINISTRATION

DMO V-4—DELEGATION OF AUTHORITY TO THE ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION

DMO V-7—GENERAL POLICIES FOR STRATEGIC AND CRITICAL MATERIALS STOCKPILING

DMO 8600.1—GENERAL POLICIES FOR STRATEGIC AND CRITICAL MATERIALS STOCKPILING

1. *Purpose.* This order sets forth policies for the administration of strategic and critical materials stockpiling.

2. *Cancellation.* This order supersedes Defense Mobilization Order V-4 (19 F.R. 7458, November 19, 1954), Defense Mobilization Order I-17 (20 F.R. 3437, May 17, 1955), Defense Mobilization Order V-7 (24 F.R. 10308, Dec. 19, 1959) and Amendment 1 thereof (27 F.R. 4169, May 2, 1962).

3. *Policies.* By virtue of the authority vested in me by Executive Order 11051, the following policies are promulgated to govern the administration of strategic and critical materials stockpiling:

a. *General.* The strategic stockpile shall be so administered as to assure the availability of strategic and critical materials in a war emergency.

b. *Period covered by stockpiling.* All strategic stockpile objectives for conven-

tional war shall be limited to meeting estimated shortages of materials for a three-year emergency period. Strategic stockpile objectives for nuclear war involving attack on the United States, shall be designed to meet estimated shortages of materials during (a) actual hostilities and (b) the reconstruction of the national economy to a point where it is adequate for national defense.

c. *Stockpile objectives.* Strategic stockpile objectives shall be adequate for limited or general, conventional or nuclear war, whichever shows the largest supply requirements deficit to be met by stockpiling.

d. *Emergency requirements.* The requirements estimates for limited or general, conventional or nuclear war shall, where appropriate, reflect specific requirements to the extent available. It shall be assumed that the total requirements will approximate the capacity of industry to consume, taking into account necessary wartime limitation, conservation and substitution measures. Requirements shall be discounted for wartime losses of consuming capacity to the extent that such losses can be reliably estimated. Departments and agencies having responsibilities with regard to requirements data on stockpile materials shall review such data and provide the Director of the Office of Emergency Planning annually with information as to all significant changes.

e. *Emergency supplies.* Estimates of supply for the mobilization period shall be based on readily available capacity and known resources. No reliance shall be placed on foreign sources of supply beyond North America and comparably accessible sources during an emergency. The share of an accessible foreign source of supply available to the United States shall be discounted to reflect the risks involved internally in the supply country and the risks of concentration of the sources. Domestic supplies shall be discounted to reflect vulnerability to total or partial destruction by overt to covert action. In cases of excessive concentration particularly, provision shall be made for supplies during the estimated time required to restore capacity and operations. Departments and agencies having the responsibilities with regard to supply data on stockpile materials shall review such data and provide the Director of the Office of Emergency Planning annually with information as to all significant changes.

f. *Provision for special-property materials.* Arrangements shall be made for the regular availability of objective scientific advice to assist in the evaluation of prospective needs for high-temperature and other special-property materials. Such materials shall be stockpiled if reasonably firm minimum requirements indicate the existence of a supply deficit in the event of an emergency.

g. *Supply-requirements reviews.* The supply-requirements balance for any material that is now or may become important to defense shall be kept under continuing surveillance. Supply-requirements data submitted pursuant to paragraphs d. and e. above shall be ex-

amined upon receipt. A full-scale review may be undertaken at any time that a change is believed to be taking place that would have a significant bearing on the wartime readiness position. Priority of review shall be given to materials under procurement.

h. Procurement policy. Unfilled objectives shall be attained expeditiously by cash procurement, barter, surplus transfers or otherwise as the Director shall deem appropriate. Long term contracts shall contain termination clauses whenever possible. Although various measures that are feasible shall be considered for meeting a materials deficit in an emergency, measures other than stockpiling shall be undertaken only after it is clear that stockpiling is not the best solution.

i. Maintenance of the mobilization base. A portion of the mobilization base comprises existing or projected productive capacity the output of which will be relied on to fill defense requirements. All inventories of Government-owned materials held for long-term storage are a part of the mobilization base and should be weighed in determining the need for a relevant portion of the productive segment of the mobilization base. The maintenance of any portion of the productive segment of the mobilization base through stockpile procurement shall be undertaken only within unfilled stockpile objectives.

j. Upgrading to ready usability. In order to satisfy the initial surge of abnormal demands following intensive mobilization either in a general or limited, conventional or nuclear war, subobjectives of stockpile materials shall be established for upgraded forms of such materials for immediate use in such circumstances. For this purpose a minimum readiness inventory shall be provided near centers of consumption. To the greatest extent practicable the amounts of such inventories should be based on the largest of the calculated mobilization requirements for any of the foregoing types of war during the first six months of the first year of mobilization. Materials in Government inventories may be upgraded for such stockpiling purposes only when the net cost of such processing including transportation and handling is less than the cost of new material. Materials should be upgraded to forms which will permit the greatest use-flexibility. Surplus materials may be used to pay for the upgrading of the same or other materials required to meet objectives providing that the use of excess materials for this purpose is in conformance with disposal criteria.

k. Beneficiation of subspecification materials. Subspecification-grade materials in Government inventories may be beneficiated within the limits of the objectives when this can be accomplished at less cost than buying new material.

l. Cancellation of commitments. Commitments for deliveries to national stockpile and Defense Production Act inventories beyond the objectives shall be cancelled or reduced when settlements can be arranged which would be mutually satisfactory to the supplier and the Gov-

ernment and which would not be disruptive to the economy or to projects essential to the national security. Such settlements may take into account anticipated profits and cover adjustments for above-market premiums. The settlement of commitments may be made through the payment of cash or through the use of surplus materials. Responsibility with respect to the settlement of commitments in the light of over-all interests of the Government rests with the Administrator of General Services who shall keep other agencies advised and consult with them to the extent appropriate.

m. Retention of other inventories. Within the limits of unfilled stockpile objectives, stockpile-grade materials in the Defense Production Act and the Supplemental Stockpile Inventories shall be retained for national stockpile purposes.

n. Disposals. The Director of the Office of Emergency Planning will authorize the disposal of excess materials whenever possible under the following conditions: (a) avoidance of serious disruption of the usual markets of producers, processors and consumers, (b) avoidance of adverse effects on the international interests of the United States, (c) due regard to the protection of the United States against avoidable loss, (d) avoidance of adverse effects upon domestic employment and labor disputes, and (e) except when materials are channeled to other agencies for their direct use, consultation with the Departments of the Interior, Commerce, State, Agriculture, Defense, Labor, and other governmental agencies concerned, and consultation as appropriate with the industries concerned. If within 30 days after such consultation either the Department of State or the Department of the Interior indicates an objection to the proposed plan which, after discussion, the Director does not support, he shall so notify the President and present the issue to him for decision. To the extent possible disposals should be made in accordance with long-run disposal plans which have been worked out in consultation with the interested departments and which take into account probable trends in supply and price both at home and abroad.

In making such disposals preference shall be given to materials in the Defense Production Act inventories.

Disposals of materials that deteriorate, that are likely to become obsolete, that do not meet quality standards, or that do not have stockpile objectives, are to be expedited.

The Administrator of General Services shall be responsible for conducting negotiations for the sale of materials and will consult with and advise the agencies concerned.

o. Public notice on disposals. Generally the sale of excess materials acquired under the Defense Production Act will be made only after appropriate public announcement of the quantity or quantities to be offered in a specified period of time.

p. Direct Government use. Government agencies which directly use strategic and critical materials shall fulfill their requirements through the use of

materials in Government inventories that are excess to the needs thereof whenever such action is found to be consistent with over-all disposal policies and with the best interests of the Government. Except where appropriate in the judgment of the Administrator of General Services, the requirements of subsection n, above, with respect to approval by Government departments or agencies and consultation with industries, shall not be applicable to transfers of strategic and critical materials for direct Government use.

4. Delegation of authority—*a. Preparation of reports.* The Administrator of General Services shall prepare on behalf of the Director of the Office of Emergency Planning and forward to him for transmittal to the Congress the reports required by section 304 of the Defense Production Act of 1950, as amended, and section 4 of the Strategic and Critical Materials Stock Piling Act.

b. Supplemental Stockpile. The Administrator of General Services shall on behalf of the Director of the Office of Emergency Planning and in accordance with programs certified by him, purchase or contract for the purchase of materials for the Supplemental Stockpile under Title I of the Agricultural Trade Development and Assistance Act of 1954, as amended.

5. Effective date. This order shall take effect on the date hereof.

Dated: March 30, 1964.

EDWARD A. McDERMOTT,

Director,

Office of Emergency Planning.

[F.R. Doc. 64-3608; Filed, Apr. 13, 1964; 8:46 a.m.]

Title 43—PUBLIC LANDS: INTERIOR

Chapter II—Bureau of Land Management, Department of the Interior

APPENDIX—PUBLIC LAND ORDERS

[Public Land Order 3374]

[Los Angeles 0165220]

CALIFORNIA

Correcting Public Land Order No. 3338 of February 24, 1964

F.R. Doc. No. 64-1919, appearing as Public Land Order No. 3338, in the issue of February 28, 1964, at pages 2787-8, is hereby corrected in the following particulars:

a. In T. 6 N., R. 20 W., San Bernardino Meridian, sec. 31, "S $\frac{1}{2}$ NE $\frac{1}{2}$ " is corrected to read "S $\frac{1}{2}$ NE $\frac{1}{4}$ ".

b. In T. 8 N., R. 20 W., San Bernardino Meridian, the description "SW $\frac{1}{4}$ SW $\frac{1}{4}$ " in the first line of the land description should be referenced to Sec. 4 of the township (an error in publication).

JOHN A. CARVER, Jr.,

Assistant Secretary of the Interior.

APRIL 8, 1964.

[F.R. Doc. 64-3609; Filed, Apr. 13, 1964; 8:46 a.m.]