CFR Part 20) and § 514.11(e)(2)(ii) (21 CFR 514.11(e)(2)(ii)), a summary of safety and effectiveness data and information submitted to support approval of this application may be seen in the Dockets Management Branch (HFA-305), Food and Drug Administration, Rm. 4-62, 5600 Fishers Lane, Rockville, MD 20857, from 9 a.m. to 4 p.m., Monday through Friday.

The Center for Veterinary Medicine has carefully considered the potential environmental effects of this action and has concluded that the action will not have a significant impact on the human environment and that an environmental impact statement therefore will not be prepared. The Center's finding of no significant impact and the evidence supporting this finding, contained in a statement of exemption (pursuant to 21 CFR 25.1(f)(1)(ii)(*b*), may be seen in the Dockets Management Branch (address above).

List of Subjects in 21 CFR Part 524

Animal drugs, topical.

Therefore, under the Federal Food, Drug, and Cosmetic Act (sec. 512(i), 82 Stat. 347 (21 U.S.C. 360b(i))) and under authority delegated to the Commissioner of Food and Drugs (21 CFR 5.10) and redelegated to the Center for Veterinary Medicine (21 CFR 5.83), Part 524 is amended by adding new § 524.1044f to read as follows:

PART 524—[AMENDED]

PART 524—OPHTHALMIC AND TOPICAL DOSAGE FORM NEW ANIMAL DRUGS NOT SUBJECT TO CERTIFICATION

§ 524.1044f Gentamicin sulfate, betamethasone valerate topical spray.

(a) *Specifications.* Each milliliter of spray contains gentamicin sulfate equivalent to 0.57 milligram of gentamicin base and betamethasone valerate equivalent to 0.284 milligram of betamethasone.

(b) *Sponsor.* See No. 000085 in § 510.600(c) of this chapter.

(c) *Conditions of use.* (1) The drug is used in dogs in the treatment of infected superficial lesions caused by bacteria sensitive to gentamicin.

(2) For the treatment of infected superficial lesions, the lesion and adjacent area should be properly cleaned before treatment. Excessive hair should be removed. Hold bottle upright 3 to 6 inches from the lesion and depress the sprayer head twice. One actuation of the sprayer delivers 0.7 milliliter of the spray. The drug should be administered with two spray actuations 2 to 4 times daily for 7 days.

(3) If hypersensitivity to any of the components occurs, treatment should be discontinued and appropriate therapy instituted. The antibiotic susceptibility of the pathogenic organism should be determined prior to use of this preparation. Administration of recommended doses beyond 7 days may result in delayed wound healing. Animals treated longer than 7 days should be monitored closely.

(4) Federal law restricts this drug to use by or on the order of a licensed veterinarian.

Effective date. January 7, 1985.

(Sec. 512(i), 82 Stat. 347 (21 U.S.C. 360b(i)).)

Dated: December 31, 1984.

Lester M. Crawford,

Director, Center for Veterinary Medicine.

[FR Doc. 85-314 Filed 1-4-85; 8:45 am]

BILLING CODE 4160-01-M

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[T.D. 8005]

Income Tax; Taxable Years Beginning After December 31, 1953; Investments in Nonpurpose Obligations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary income tax regulations relating to the tax exempt status of industrial development bonds. These regulations affect all purchasers, governmental issuers, and beneficiaries of tax exempt industrial development bonds. In addition, the text contained in the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in the Proposed Rules section of this issue of the **Federal Register**.

DATES: These regulations are effective for governmental obligations issued after December 31, 1984.

FOR FURTHER INFORMATION CONTACT: Mitchell H. Rapaport of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3740).

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary regulations under section 103(c)(6) of the Internal Revenue Code as amended by section 624 of the Tax Reform Act of 1984 (Pub. L. 98-369; 98 Stat. 922). Further, new § 1.103-15AT is added by this document to Part 1 of Title 26 of the Code of Federal Regulations.

Explanation of Provisions

Section 103(c) of the Code provides that arbitrage bonds shall be treated as not described in section 103(a). Section 103(c)(6) of the Code provides additional arbitrage limitations. The requirements of section 103(c)(6) apply to industrial development bonds other than obligations described in section 103(b)(4)(A), relating to projects for residential rental property, and housing program obligations issued under section 11(b) of the Housing Act of 1937. The temporary regulations apply to obligations issued after December 31, 1984.

Section 1.103-15AT places restrictions on investments in nonpurpose obligations. The term "nonpurpose obligation" is defined in § 1.103-15AT(b)(2) as any security or obligation that is acquired with the gross proceeds of an issue and that is not acquired to carry out the governmental purpose of the issue. Thus, for example, acquired obligations in a reasonably required reserve or replacement fund are nonpurpose obligations subject to the requirements of section 103(c)(6) and § 1.103-15AT.

The requirements of section 103(c)(6) and § 1.103-15AT apply to nonpurpose obligations acquired with the gross proceeds of an industrial development bond. The term "gross proceeds" is defined in § 1.103-15AT(b)(6) as including original proceeds, investment proceeds, amounts held in a sinking fund, transferred proceeds, and other amounts received as a result of investing the original proceeds of an issue. In addition, certain funds that replace bond proceeds specifically set out in § 1.103-15AT(b)(6) are gross proceeds of an issue. It is intended that proposed regulations to be issued in the future, which will define the concept of replacement proceeds for all purposes of section 103(c), may expand the categories of replacement proceeds that are gross proceeds.

Section 1.103-15AT(c) limits the amount of nonpurpose obligations with a yield higher than the yield on the issue in which gross proceeds of the issue may be invested. In general, the amount of such investments is limited to 150 percent of the debt service on the issue for the current bond year. Generally, yield is calculated in the manner prescribed by § 1.103-13(c) on the basis of the issue price. Thus, for example,

premiums paid to insure a governmental issue may, in some circumstances, be treated as interest paid on the issue. Section 1.103–15AT(c)(1)(ii) also requires that the amount of nonpurpose obligations with a yield higher than the yield on the issue be reduced as the amount of outstanding obligations is reduced. The maximum nonpurpose investment rule does not apply to investments made during certain temporary periods.

Section 1.103–15AT(c)(4) provides a special rule with respect to variable rate obligations. Generally, § 1.103–15AT(c)(4) provides a mechanism for determining in advance the debt service on variable rate obligations in order to meet the maximum nonpurpose investment rule.

Section 1.103–15AT(d) requires that the issuer of any issue pay to the United States the excess of the aggregate amount earned on all nonpurpose obligations over the amount that would have been earned if such nonpurpose obligations were invested at a rate equal to the yield on the issue, plus any income attributable to such excess. Issuers must pay the required amounts to the United States not less frequently than every 5 years.

Section 1.103–15AT(d)(2) provides that the determination of the amount required to be paid to the United States must be made at least annually. The frequency of this determination is necessitated by section 103(c)(6)(F) and § 1.103–15AT(f), which provide that gross income does not include the amount required to be paid to the United States.

Two special rules are provided with respect to the rebate requirement. First, § 1.103–15AT(d)(4) provides that amounts earned on a bona fide debt service fund need not be taken into account in determining the amount required to be paid to the United States if the gross earnings on such fund for the bond year is less than $100,000. Second, § 1.103–15AT(d)(5) provides that the rebate requirement does not apply where the gross proceeds of an issue (other than amounts contributed to a bona fide debt service fund) are expended for the governmental purpose of the issue within 6 months of the date of issue. If all of the gross proceeds of an issue are initially expended within 6 months of the date of issue but gross proceeds (other than amounts contributed to a bona fide debt service fund) later become available, the issue will not fail to satisfy the rebate requirement if the amount described in § 1.103–15AT(d)(1) with respect to such additional gross proceeds after they become available is paid to the United States in accordance with the requirements of § 1.103–15AT(e).

Section 1.103–15AT(d)(6) provides that an issue does not comply with the rebate requirement if a prohibited payment is made. A prohibited payment is the payment to any other party of an amount that is required to be paid to the United States. The notice of proposed rulemaking cross-referenced in the Proposed Rules section of this issue of the **Federal Register** specifically requests comments on these provisions.

Non-Applicability of Executive Order 12291

The Treasury Department has determined that these temporary regulations are not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

Regulatory Flexibility Act

A general notice of proposed rulemaking is not required by 5 U.S.C. 553 for temporary regulations. Accordingly, the temporary regulations do not constitute regulations subject to the Regulatory Flexibility Act. (5 U.S.C. Chapter 6.)

Paperwork Reduction Act

The collection of information requirements contained in these regulations has been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB under control number 1545–0720.

Drafting Information

The principal author of these temporary regulations is Mitchell H. Rapaport of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

List of Subjects in 26 CFR 1.61–1 Through 1.281–4

Income taxes, Taxable income, Deductions, Exemptions.

Amendments to the Regulations

PART 1—[AMENDED]

For the reasons set out in the preamble, Part 1 of Title 26 of the Code of Federal Regulations is amended as follows:

New § 1.103–15AT is added following § 1.103–15 to read as follows:

§ 1.103–15AT Investments in nonpurpose obligations.

(a) *In general*—(1) *General rule.* (i) Under section 103(c)(6), any obligation issued after December 31, 1984, that is part of an issue of industrial development bonds (other than an issue described in paragraph (a)(1)(ii) of this section) shall be treated as an obligation that is not described in section 103(a), from the date of issue, unless the issue meets the requirements of section 103(c)(6) (C) and (D) and this section. Thus, for example, if a payment required to be made under paragraph (d) of this section with respect to an issue of obligations is not made in a timely manner, those obligations are not described in section 103(a) as of the date of issue. An issue meets the requirements of this section only if the issue meets the requirements of paragraphs (c) and (d) of this section. Except as otherwise provided in this section, compliance with the requirements of this section is to be determined on the basis of the actual facts, not on the basis of the issuer's reasonable expectations on the date of issue. The requirements of section 103(c)(6) and this section are applicable in addition to the other requirements of section 103(c) and §§ 1.103–13, 1.103–14, and 1.103–15.

(ii) The requirements of section 103(c)(6) and this section do not apply to—

(A) Any obligation described in section 103(b)(4)(A), relating to obligations issued to provide a project for residential rental property, or

(B) Any housing program obligation issued under section 11(b) of the United States Housing Act of 1937.

(2) *Innocent mistake.* An issue will not fail to meet the requirements of this section merely because of an inadvertent, insubstantial error (*e.g.*, in arithmetic) if the error is corrected within a reasonable period of time after the error is discovered or should have been discovered by the exercise of reasonable diligence.

(b) *Definitions.* For purposes of this section the following definitions apply:

(1) *Industrial development bond.* The term "industrial development bond" shall have the meaning given it by section 103(b)(2) and § 1.103–7.

(2) *Nonpurpose obligations.* (i) The term "nonpurpose obligation" means any security (as defined in § 1.103–13(b)(4)(ii)) or any obligation (as defined in § 1.103–13 (b)(4)(iii)) other than an obligation described in section 103(a) in which gross proceeds of an issue are invested and which is not acquired to carry out the governmental purpose of

the issue. See § 1.103–13(b)(4)(iv)(A) for rules defining the governmental purpose of the issue. Thus, for example, acquired obligations (as defined in § 1.103–13(b)(4)(i)) purchased with the gross proceeds of an issue that are invested in a reasonably required reserve or replacement fund are nonpurpose obligations.

(ii) In determining the nonpurpose obligations in which gross proceeds of an issue are invested, nonpurpose obligations not purchased with the gross proceeds of the issue may not be allocated to such proceeds.

(3) *Yield.* Except as otherwise provided in this section, the term "yield" shall have the meaning given it by § 1.103–13(c) except that the yield on the issue shall be determined on the basis of the issue price.

(4) *Issue price.* The term "issue price" shall have the same meaning given it by sections 1273(b) and 1274. Thus, in general, such term means the initial offering price to the public (not including bond houses and brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers) at which price a substantial amount of the obligations were sold or, if privately placed, the price paid by the first buyer of such obligations or the acquisition cost of the first buyer.

(5) *Debt service.* The term "debt service" on an issue for any bond year means the scheduled amount of interest and amortization of principal payable for that year with respect to the issue. For purposes of determining the debt service on an issue, there shall not be taken into account amounts scheduled with respect to any obligation (or portion thereof) that has been retired before the beginning of the bond year.

(6) *Gross proceeds.* (i) Except as otherwise provided in paragraph (d)(5)(ii), the term "gross proceeds" means:

(A) Original proceeds (as defined in § 1.103–13(b)(2)(i)),

(B) Investment proceeds (as defined in § 1.103–13(b)(2)(ii)),

(C) Transferred proceeds (as defined in § 1.103–14(e)(2)(ii)),

(D) Amounts treated as proceeds of the issue under § 1.103–13(g) (relating to invested sinking funds),

(E) Amounts invested in a reasonably required reserve or replacement fund (as defined in § 1.103–14(d)),

(F) Securities or obligations pledged as security for payment of debt service on an issue by an ultimate obligor (or a related person), the issuer, or by a governmental unit of which the issuer is a part,

(G) Amounts received with respect to acquired purpose obligations (*e.g.*, lease payments, repayments of principal),

(H) Other amounts used to pay debt service on the issue, and

(I) Other amounts received as a result of investing the amounts described in this paragraph (b)(6)(i) with respect to an issue.

For purposes of this section, amounts received from the investment of the gross proceeds of an issue are investment proceeds regardless of whether such amounts are commingled by any person with tax or other revenues.

(ii) The following example illustrates the application of this subparagraph:

Example. On January 30, 1985, State A issues a $5,000,000 issue of industrial development bonds with a term of 30 years at par to finance the acquisition of a manufacturing facility to be leased to X Corporation for 30 years. Issuance costs of $100,000 are paid. A reasonably required reserve fund is funded with $250,000 of the original proceeds. X Corporation makes semiannual lease payments to A in an amount equal to the debt service on the bonds. The amounts received from X are placed in a bona fide debt service fund until such amounts are needed to pay debt service. In January, 1990, X sells its rights under the lease to an unrelated party for $10,000,000. X places $5,000,000 of the sales proceeds in a fund pledged as security for payment of debt service on the issue and invests the fund in a manner such that the amount in the fund will be sufficient to meet the debt service on the bonds. The following amounts are gross proceeds of the issue: $4,900,000 original proceeds, all earnings on the reasonably required reserve fund, all lease payments received from X, all earnings on the bona fide debt service fund, and $5,000,000 of the proceeds from the sale by X of its rights under the lease and the income earned on all of these amounts.

(7) *Variable rate obligation.* The term "variable rate obligation" means any obligation the yield on which, under the terms of the obligation, is adjusted periodically according to a prescribed formula such that the yield over the term of the obligation cannot be determined on the date of issue.

(8) *Issue and date of issue.* The term "issue" shall have the same meaning given it by § 1.103–13(b)(10). The term "date of issue" has the meaning given it by § 1.103–13(b)(6). A loan agreement pursuant to which loan proceeds will be advanced periodically is treated as a single issue the date of issue of which is the first date on which more than a *de minimis* amount of loan proceeds is advanced. An issue that is a "multipurpose issue" (as defined in § 1.103–13(b)(9)) is treated as separate issues for purposes of this section.

(9) *Bond year.* The term "bond year" with respect to an issue means the 1-year period beginning on the day after the expiration of the preceding bond year of such issue. The first bond year of an issue begins on the date of issue and ends 1 year later.

(10) *Related person.* The term "related person" shall have the same meaning given it by section 103(b)(6)(C) and § 1.103–10(e).

(11) *Computation period.* The term "computation period" means each period from the date of issue through the date on which a determination of the amount described in paragraph (d)(1) is made.

(c) *Maximum nonpurpose investments*—(1) *In general.* Except as otherwise provided in this paragraph, an issue meets the requirements of this paragraph only if—

(i) At no time during any bond year, does the aggregate amount of gross proceeds of the issue invested in nonpurpose obligations with a yield higher than the yield on the issue exceed 150 percent of the debt service on the issue for such bond year, and

(ii) The aggregate amount of gross proceeds of the issue invested in nonpurpose obligations with a yield higher than the yield on the issue is promptly and appropriately reduced as the amount of outstanding obligations of the issue is reduced.

For purposes of paragraph (c)(1)(ii), the aggregate amount invested in nonpurpose obligations with a yield higher than the yield on the issue will be considered promptly and appropriately reduced if, beginning in the first bond year ending after the expiration of the temporary period for original proceeds described in paragraph (c)(2)(i), that amount is reduced within 30 days of any redemption of obligations resulting in a reduction in annual debt service so that after such reduction the issue complies with the requirements of paragraph (c)(1)(i).

(2) *Temporary periods.* For purposes of this paragraph, the aggregate amount of gross proceeds of an issue invested in nonpurpose obligations will be determined without regard to gross proceeds of such issue while such amounts are:

(i) Invested for the initial temporary period provided in § 1.103–14 (b)(1) until needed for accrued interest or for the governmental purpose of the issue,

(ii) Contributed to a bona fide debt service fund (as defined in § 1.103–13 (b)(12)) and invested for no longer than the temporary period provided in § 1.103–14 (b)(10),

(iii) Invested during the temporary period described in § 1.103–14 (b)(8) or § 1.103–14 (b)(12), relating to amounts treated as proceeds of an issue,

(iv) Invested during the temporary period described in § 1.103–14 (b)(9), relating to earnings on amounts treated as proceeds,

(v) Invested during the temporary period described in § 1.103–14 (b)(6), relating to investment proceeds,

(vi) Invested during the temporary period provided in § 1.103–14 (e)(3), relating to refunding issues, or

(vii) Deposited in a revolving fund (as defined in § 1.103–14 (b)(11)).

(3) *Valuation of nonpurpose obligations.* For purposes of this paragraph, in determining the aggregate amount of gross proceeds of an issue invested in nonpurpose obligations, each nonpurpose obligation in which gross proceeds of an issue are invested, including an obligation or security that was not a nonpurpose obligation when acquired but that becomes a nonpurpose obligation with respect to an issue (*e.g.*, obligations pledged as security for the issue), shall be valued as if acquired for its fair market value at the time such obligation or security becomes a nonpurpose obligation of such issue. In addition, the yield on such nonpurpose obligation shall be determined based on such fair market value. The issuer must value nonpurpose obligations as described above on the date acquired and need not revalue such obligations unless the bond indenture or related documents require such obligations to be revalued according to their fair market value.

(4) *Variable rate obligations.* (i) For purposes of this paragraph, the yield and the debt service on an issue containing a variable rate obligation will be determined by assuming that the rate of interest on such obligation will be—

(A) For the first bond year, the initial rate of interest for such obligation as determined under the prescribed formula on the date of issue (without regard to any fixed rate initially applicable to such obligation), and

(B) For any subsequent bond year, the weighted average rate of interest for such obligation during the preceding bond year.

The determination of debt service on an issue must be made on the first day of each bond year. An issue containing variable rate obligations will not be treated as failing to satisfy the requirements of paragraph (c)(1)(i) if, after the expiration of the temporary period for original proceeds described in paragraph (c)(2)(i), the nonpurpose obligations with a yield higher than the yield on the issue in excess of 150 percent of the debt service on the issue are disposed of within 30 days of the annual determination of the debt service on the issue and within 30 days of any redemption of obligations resulting in a reduction in annual debt service.

(ii) For purposes of this paragraph, the yield on a nonpurpose obligation that is a variable rate obligation shall be determined on the date the nonpurpose obligation is acquired and on the first day of each bond year by assuming that the rate of interest will be the weighted average rate of interest for such obligation during the preceding 1 year period (or portion thereof in which the obligation was outstanding). With respect to a nonpurpose obligation purchased on its date of issue, the yield for the first bond year shall be determined by assuming that the rate of interest will be the initial rate of interest for such obligation as determined under the prescribed formula on the date of issue (without regard to any fixed rate initially applicable to such obligation).

(iii) The following examples illustrate the application of this paragraph (c)(4):

Example (1). On March 1, 1987, County X issues a $5,000,000 issue of industrial development bonds with a term of 30 years. The obligations comprising the issue are variable rate obligations the interest on which is adjusted every 30 days according to a formula prescribed in the bond indenture such that the yield of the obligations over their terms cannot be determined on the date of issue. County X immediately loans the original proceeds of the issue to Corporation W. A reasonably required reserve fund is funded with $500,000 of the original proceeds. All of the proceeds allocated to the reserve fund are used to acquire nonpurpose obligations earning 8 percent. No other nonpurpose obligations are acquired. On March 1, 1987, the yield on the County X obligations is 7 percent. During the first bond year (*i.e.*, March 1, 1987, through February 29, 1988) and the second bond year, no principal payments are scheduled to be made. Interest payments on the issue are scheduled for September 1, 1987, and March 1, 1988. Regardless of the actual rate of interest on the issue during the first bond year, both County X and Corporation W must assume, for purposes of paragraph (c), that the rate of interest will be 7 percent throughout the first bond year. Thus, the debt service on the issue for the first bond year is assumed to be $350,000. During the first bond year up to $525,000 (*i.e.*, 150 percent of $350,000) of the gross proceeds of the issue may be invested in nonpurpose obligations with a yield in excess of 7 percent. Since only $500,000 of the gross proceeds of the issue are invested in nonpurpose obligations with a yield in excess of 7 percent, the issue meets the requirements of paragraph (c)(1)(i) during the first bond year.

Example (2). The facts are the same as in example (1), except that during the first bond year the weighted average rate at which interest was earned was 6 percent. The issue does not fail to meet the requirements of paragraph (c)(1)(i) for the first bond year. The determination of the debt service on the issue for the second bond year must be based on the weighted average interest rate at which interest was paid during the first bond year. Thus, it is assumed that the scheduled amount of interest to be paid during the second bond year is $300,000. In order to comply with the requirements of paragraph (c)(1)(i) during the second bond year, $50,000 worth of nonpurpose obligations must be disposed of within 30 days of the end of the first bond year.

(5) *No disposition in case of loss.* (i) Nonpurpose obligations subject to the maximum investment rule of paragraph (c)(1) need not be sold or disposed of if the sale or disposition would result in the realization of a loss for Federal income tax purposes that exceeds the amount that would be paid to the United States pursuant to paragraph (d) (but for such sale or disposition) at the time of such sale or disposition (not including amounts that had been previously paid to the United States) if a payment under paragraph (d) were due at such time.

(ii) Paragraph (c)(5)(i) shall not apply to the extent that other nonpurpose obligations acquired with the gross proceeds of the issue may be sold or disposed of without incurring a loss in excess of the amount that would be paid to the United States pursuant to paragraph (d) (but for such sale or disposition) at the time of such sale or disposition if a payment under paragraph (d) were due at such time. In addition, with respect to any nonpurpose obligation that (under the rule described in paragraph (c)(5)(i)) need not be sold or disposed of, paragraph (c)(5)(i) shall cease to apply 30 days after the last day of the first computation period ending thereafter on which the obligation can be sold or disposed of without incurring a loss in excess of the amount that would be paid to the United States pursuant to paragraph (d) (but for such sale or disposition) if a payment under paragraph (d) were due at such time. For purposes of this paragraph (c)(5), nonpurpose obligations in which gross proceeds of an issue are invested will not be treated as a single issue of obligations. Thus, for example, if an issuer uses the proceeds of an issue to acquire 2 blocks of nonpurpose obligations (such as, for example, United States Treasury obligations) at different times, or with different interest rates or maturity periods for each block, the 2 blocks of nonpurpose obligations will be treated as separate nonpurpose obligations for purposes of this paragraph (c)(5).

(iii) The following examples illustrate the application of this paragraph (c)(5):

Example (1). On January 1, 1986, X issued an issue of industrial development bonds. A reasonably required reserve fund is funded with a portion of the gross proceeds of the issue, and such proceeds are invested at the same time in identical obligations of the United States Treasury (in $5,000 denominations) with a yield higher than the yield on the issue. These obligations were purchased on January 1, 1986, for $1,000,000 (fair market value). On January 1, 1991, it is determined that, due to the redemption of obligations resulting in a reduction in annual debt service, the maximum amount of gross proceeds that may be invested in nonpurpose obligations with a yield higher than the yield on the issue is $800,000. Therefore, $200,000 of the Treasury obligations must be disposed of. X has not made any payments to the United States under paragraph (d). On January 1, 1991, X determines that, under this paragraph (d), it must pay to the United States $30,000. On January 1, 1991, Treasury obligations held in the reasonably required reserve fund that were acquired for $200,000 can be sold for only $160,000. Thus, a sale of these obligations in order to satisfy the requirements of paragraph (c)(1) will result in the realization of a loss for Federal income tax purposes in excess of the amount required to be paid to the United States. Under paragraph (c)(5), X need not sell any of the nonpurpose obligations, since such a sale would result in a loss in excess of the amount that is required to be paid to the United States.

Example (2). On March 15, 1987, Z issues an issue of industrial development bonds. On March 15, 1987, a reasonably required reserve fund is funded with a portion of the gross proceeds of the issue, and such proceeds are invested in (i) identical obligations of the United States Treasury (in $5,000 denominations) with a yield higher than the yield on the issue, which were purchased at the same time for $300,000 (par) and (ii) other identical nonpurpose obligations with a yield higher than the yield on the issue which were purchased at the same time for $250,000 (par). Both the Treasury obligations and the other nonpurpose obligations were acquired at a cost equal to their fair market value. On March 15, 1997, it is determined that, due to redemption of obligations resulting in a reduction in annual debt service, the maximum amount of gross proceeds that may be invested in nonpurpose obligations with a yield higher than the yield on the issue is $300,000. Z has not made a payment under paragraph (d) within the preceding 5 years. Z determines that, under paragraph (d), it must pay to the United States $50,000. At this time the Treasury obligations can be sold for 80 percent of par and the other nonpurpose obligations for 92 percent of par. If all of the Treasury obligations are sold to comply with the maximum nonpurpose investment rule, a loss in excess of the amont required to be paid to the United States would be realized. Therefore, Z is not required to dispose of any of the Treasury obligations. Z must, however, dispose of the other nonpurpose obligations. Although Z will realize a loss on this sale, the amount of the loss is not in excess of the amount that Z is required to pay to the United States.

(d) *Rebate requirement*—(1) *In general.* Except as otherwise provided in this paragraph, an issue meets the requirements of this paragraph only if an amount equal to the sum of—

(i) The excess of—

(A) The aggregate amount earned from the date of issue on all nonpurpose obligations in which gross proceeds of the issue are invested (other than amounts attributable to an excess described in this paragraph (d)(1)(i)), over

(B) The amount that would have been earned if the yield on such nonpurpose obligations (other than amounts attributable to an excess described in this paragraph (d)(1)(i)) had been equal to the yield on the issue, plus

(ii) Any income attributable to the excess described in paragarph (d)(1)(i), is calculated in accordance with the requirements of this paragraph and is paid to the United States in accordance with the requirements of paragraph (e) by the issuer or a person acting on behalf of the issuer.

(2) *Calculation of rebate amount.* (i) In determining the amount described in paragraph (d)(1)(i)(A), except as otherwise provided in paragraph (d)(2)(ii), the aggregate amount earned on nonpurpose obligations shall include all income realized under Federal income tax accounting principles (whether or not the person earning such income is subject to Federal income tax) with respect to such obligations and with respect to the reinvestment of investment receipts from such obligations (without regard to the transaction costs incurred in acquiring, carrying, selling, or redeeming such obligations). Such income shall include, for example, gain or loss realized on the disposition of such obligations (without regard to when such gains are taken into account under section 453) and income under section 1272. In addition, if any nonpurpose obligation is retained after retirement of an issue, any unrealized gain or loss as of the date of retirement of that issue must be taken into account in calculating the aggregate amount earned on nonpurpose obligations.

(ii) In determining the amount described in paragraph (d)(1)(i), an obligation or security shall be treated as acquired for its fair market value at the time it becomes a nonpurpose obligation, so that gain or loss on the disposition of such an obligation or security shall be computed with reference to such fair market value as its adjusted basis.

(iii) In determining the amount described in paragraph (d)(1)(i)(B), the yield on an issue shall be determined based on the actual yield of such issue during the period between the date of issue and the date the computation is made (with adjustments for discount or premium).

(iv) In determining the amount described in paragraph (d)(1)(ii), all income attributable to the excess described in paragraph (d)(1)(i) must be taken into account, whether or not that income exceeds the yield on the issue, and may not be treated as "negative arbitrage."

(v) The following examples illustrate the application of this paragraph (d)(2):

Example (1). On December 1, 1985, Authority T issues a $1,000,000 issue of industrial development bonds described in section 103(b)(4)(C) the proceeds of which will be loaned to Corporation F. F owns United States Treasury obligations that will be pledged as collateral for the Authority T issue. Under the terms of the pledge, F cannot dispose of any of the Treasury obligations while T's bonds are outstanding except to pay bondholders. Thus, the bondholders are reasonably assured that this collateral will be available if needed to pay debt service, even if T or F encounter financial difficulties. F acquired the pledged securities several years earlier at their par value ($1,000,000). If the Treasury obligations were sold by F on December 1, 1985, for their fair market value, the securities would sell at 80 percent of their par value ($800,000). For purposes of this section, the Treasury obligations pledged by F are treated as acquired at a cost equal to $800,000. Thus, the amount described in paragraph (d)(1)(i)(B) with respect to the gross proceeds of the issue invested in the Treasury obligations is equal to the amount that would have been earned if $800,000 had been invested at a rate equal to the yield on the issue. In addition, if the Treasury obligations are later sold for $800,000 the loss realized by F does not reduce the amount required to be paid to the United States under this paragraph (d).

Example (2). On December 1, 1985, Authority TT issues a $5,000,000 issue of fixed rate industrial development bonds described in section 103(b)(4)(C), the proceeds of which will be loaned to Corporation FF. The yield on the issue is 9 percent. FF owns $500,000 of United States Treasury obligations. These United States Treasury obligations will be pledged as collateral for the issue. Gross proceeds of the issue are not invested in any other nonpurpose obligations. FF acquired the pledged securities several years before the date of issue at 100 percent of par value, and their yield based on the original purchase price is 8 percent. If the United States Treasury obligations were sold by FF on December 1, 1985, for their fair market value, such obligations would sell at 80 percent of their par value. For purposes of paragraph (d), the United States Treasury obligations pledged by FF are treated as acquired at a cost equal to 80 percent of their par value. FF computes the amount described in paragraph

(d) at the close of each bond year. The amount earned on the United States Treasury obligations during the first computation period, December 1, 1985, through November 30, 1986, is $40,000. The amount that would have been earned during this period if $400,000 (80 percent of $500,000) had been invested at the yield on the issue is $36,000. The amount described in paragraph (d)(1)(i) is $4,000.

(3) *Frequency of determinations.* Determinations of the amounts described in paragraph (d)(1) shall be made at least every year and upon retirement of the last obligation of the issue. For example, if at the end of the first bond year the earnings on nonpurpose obligations exceed the amount that would have been earned if the yield on such obligations has been equal to the yield on the issue, such excess constitutes an excess described in paragraph (d)(1)(i). In the following year, all income attributable to such excess must be taken into account. Records of the determinations required by this paragraph must be retained by the issuer or a person acting on behalf of the issuer until 6 years after the retirement of the last obligation of the issue.

(4) *Special rule for bona fide debt service fund.* (i) Except as otherwise provided in this paragraph (d)(4), in determining the amounts described in paragraph (d)(1) (i) and (ii), any amount earned on a bona fide debt service fund (as defined in § 1.103–13(b)(12)) and amounts earned on such amounts, if allocated to the bona fide debt service fund, shall not be taken into account if the gross earnings on such fund for the bond year is less than $100,000. For purposes of this paragraph (d)(4), the term "gross earnings" means the aggregate amount earned on the nonpurpose obligations in which the gross proceeds contributed to the bona fide debt service fund are invested, including amounts earned on such amounts if allocated to the bona fide debt service fund. Nevertheless, the issuer may elect to take into account such aggregate amounts earned on a bona fide debt service fund for this purpose by making an irrevocable election on the date of issue in the bond indenture or a related document. Absent such an election, such amount may not be taken into account in determining the amount required to be paid to the United States.

(ii) If more than one bona fide debt service fund is established for an issue, all such funds are treated as a single fund for purposes of this paragraph (d)(4). A bona fide debt service fund for two or more issues is treated as consisting of separate bona fide debt service funds for each issue, and the portion of the bona fide debt service fund allocable to each issue is to be determined in the manner prescribed in § 1.103–13(g)(6).

(5) *Temporary investments.* (i) Notwithstanding the other requirements of this paragraph (d), an issue shall be treated as meeting the requirements of section 103(c)(6)(D) and this paragraph (d) if the gross proceeds of the issue are expended for the governmental purpose for which the issue was issued within 6 months after the date of issue. Whether proceeds are expended for the governmental purpose for which the issue was issued is to be determined by the ultimate use of such proceeds. For purposes of this paragraph (d)(5), gross proceeds used to redeem outstanding obligations of the issue are considered to be expended for the governmental purpose for which the obligations were issued. For purposes of this paragraph (d)(5), if gross proceeds of an issue cease to be proceeds of that issue under § 1.103–14(e)(2)(ii) (transferred proceeds) due to the refunding of that issue, they are not considered expended for the governmental purpose for which the issue being refunded was issued; both the prior issue and the refunding issue may, however, be treated as meeting the requirements of this paragraph (d) pursuant to this paragraph (d)(5)(i) if the gross proceeds of such issues are expended for the governmental purposes of such issues within 6 months of the appropriate dates of issue as determined in paragraph (d)(5)(iii).

(ii) For purposes of this paragraph (d)(5), gross proceeds in a bona fide debt service fund shall not be considered gross proceeds. Thus, an issue may be treated as meeting the requirements of this paragraph (d) pursuant to paragraph (d)(5)(i) even though a bona fide debt service fund is maintained for the issue throughout its term. This paragraph (d)(5)(ii) does not apply to gross proceeds in any other fund.

(iii) For purposes of this paragraph (d)(5), in order for transferred proceeds to be considered expended within 6 months after the date of issue, such proceeds must be expended for the governmental purpose for which the prior issue was issued not later than 6 months after the date of issue of the prior issue or, in the case of a series of refunding issues, 6 months after the date of issue of the original issue to provide the facility being financed. With respect to a multipurpose issue, the preceding sentence shall only apply to the portion of the issue treated as a refunding issue.

(iv) If, during the 6-month period following the date of issue, all of the gross proceeds of the issue available during that period are expended for the governmental purpose of the issue and it is not anticipated that any other gross proceeds will arise during the remainder of the term of the issue, that gross proceeds actually become available following the end of the initial 6-month period will not, in itself, cause the issue to fail to satisfy the requirements of paragraph (d)(1). The preceding sentence will apply only if the amount described in paragraph (d)(1) earned with respect to the gross proceeds that arise following the end of the initial 6-month period is paid to the United States in accordance with the requirements of paragraph (e); no payment will be required with respect to gross proceeds expended during the 6-month period following the date of issue. For example, if the gross proceeds of an issue are expended for the governmental purpose of the issue within 6 months of the date of issue but subsequently the facility is sold and the sale proceeds are placed in a fund that will be used to pay principal and interest on the issue, the issue will be considered to meet the requirements of paragraph (d)(1) if the amounts described in paragraph (d)(1) earned with respect to the sale proceeds are paid to the United States in accordance with the requirements of paragraph (e).

(v) The following examples illustrate the application of this paragraph (d)(5):

Example (1). On August 1, 1985, County C issues industrial development bonds to provide an airport as described in section 103(b)(4)(D). On August 1, 1985, County C loans the proceeds of the issue to Corporation L, a non-exempt entity that will have the airport constructed and use the completed facility in its trade or business. Prior to February 2, 1986, L does not expend all of the gross proceeds of the issue for purposes of constructing the airport. The gross proceeds of the issue have not been expended for the governmental purpose for which the bonds were issued within 6 months of the date of issue because, in determining whether the proceeds were expended for the governmental purpose within 6 months of the date of issue, the ultimate use of such proceeds must be examined. Thus, regardless of the fact that County C loaned the gross proceeds to L within 6 months of the date of issue, the gross proceeds were not used to construct the airport until after February 1, 1986.

Example (2). On December 29, 1984, State B issues a $5,000,000 issue of short-term bond anticipation notes to construct a pollution control facility, as described in section 103(b)(4)(F). The original proceeds of the issue are placed in a construction fund and are to be disbursed over the next 3 years as necessary to pay the costs of construction. On June 30, 1985, B issues a $5,000,000 issue of obligations the proceeds of which are to be

used to refund the December 29, 1984, issue. On June 30, 1985, State B uses the proceeds of the refunding issue to discharge the portion of the prior issue then outstanding. As of June 30, 1985, the proceeds of the December 29, 1984, issue become proceeds of the June 30, 1985, issue. On June 30, 1985, $2,000,000 remains in the construction fund. The June 30, 1985, refunding issue does not qualify for the temporary investment exception to the rebate requirement since all of the gross proceeds of the issue were not expended within 6 months of the date of issue of the prior issue.

Example (3). The facts are the same as in Example (2) except that the December 29, 1984, issue is refunded on March 1, 1985; within 6 months of December 29, 1984, the gross proceeds of the March 1, 1985, issue is expended on construction of the pollution control facility. The March 1, 1985, issue qualifies for the temporary investment exception to the rebate requirement, provided that no additional gross proceeds arise.

(6) *Prohibited payments*—(i) *In general.* An issue does not meet the requirements of this paragraph (d) if a prohibited payment is made. A prohibited payment is the payment, or agreement to pay, to a party other than the United States an amount that is required to be paid to the United States by entering into a transaction that reduces the amount described in paragraph (d)(1) (i)(A) or (ii) because such transaction results in a smaller profit or a larger loss than would have resulted if the transaction had been at arm's length and had the yield on the issue not been relevant to either party. For example, if any nonpurpose obligation is purchased by an ultimate obligor (or a related person), the issuer, or by a governmental unit of which the issuer is a part, for an amount in excess of the fair market value of such obligation, the excess shall be treated as a prohibited payment. Whether a nonpurpose obligation for which there is an established market is purchased or sold for an amount in excess of its fair market value shall be determined in accordance with § 1.103–13(c)(1)(iii)(B). The purchase of a United States Treasury obligation directly from the United States Treasury shall be treated as acquired for an amount not in excess of its fair market value.

(ii) *Certificates of deposit.* The purchase or sale of a certificate of deposit issued by a commercial bank will not result in a prohibited payment if the price at which it is purchased or sold is the bona fide bid price quoted by a dealer who maintains an active secondary market in such certificates of deposit. If there is no active secondary market in such certificates of deposit, the purchase or sale of a certificate of deposit will not result in a prohibited payment if the certificate of deposit has a yield: (A) As high or higher than the yield on comparable obligations trade on an active secondary market, as certified by a dealer who maintains such a market, and (B) as high or higher than the yield available on comparable obligations offered by the United States Treasury. The certification described in the preceding sentence must be executed by a dealer who maintains an active secondary market in comparable certificates of deposit and must be based on actual trades adjusted to reflect the size and term of that certificate of deposit and the stability and reputation of the person issuing the certificate of deposit.

(iii) *Investment contracts.* Nonpurpose obligations purchased or sold pursuant to an investment contract (*e.g.*, an agreement to deposit gross proceeds with a particular bank, with the deposits to bear interest at an agreed rate) will not result in a prohibited payment if (A) at least 3 bids on the investment contract from persons other than those with an interest in the issue (*e.g.*, underwriters) are received, (B) a certification is provided by the person whose bid is accepted stating that, based on that person's reasonable expectations on the date that the contract is entered into, nonpurpose obligations will not be purchased pursuant to the investment contract at a price in excess of thier fair market value or sold pursuant to the investment contract at a price less than their fair market value, (C) the yield on the investment contract is at least equal to the yield offered under the highest bid received from a noninterested party, and (D) the yield on the investment contract is at least equal to the yield offered on similar obligations under similar investment contracts (*e.g.*, the yield on investment contracts entered into by issuers of qualified mortgage bonds).

(e) *Payments*—(1) *In general.* The amount required to be paid to the United States under paragraph (d)(1) shall be paid in installments. The first payment with respect to an issue must be made not later than 30 days after the end of the fifth bond year of such issue; each subsequent payment must be made not later than 5 years after the preceding payment was due. Each installment must be in an amount that ensures that at least 90 percent of the amount described in paragraph (d)(1) with respect to the issue as of the close of the computation period will have been paid to the United States. Not later than 30 days after the retirement of the last obligation of the issue, the issuer shall pay 100 percent of the aggregate amount described in paragraph (d)(1) with respect to the issue not therefore paid to the United States. If an issue is refunded within 6 months of the date of issue and the issuer reasonably anticipates that the prior issue will qualify for the temporary investments exception to the rebate requirement, the aggregate amount described in paragraph (d)(1) required to be paid to the United States, if any, shall not be due until 30 days after the expiration of the 6-month period following the appropriate dates of issue of the prior issue.

(2) *Place for payments.* Each payment of an installment of the amount required to be paid to the United States under paragraph (d)(1) shall be filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania 19255. Each payment shall be accompanied by a copy of the Form 8038 filed with respect to the issue and a statement summarizing the issuer's determination of the amount required to be paid to the United States.

(3) *Recovery of payments.* If during any computation period the aggregate amount earned on nonpurpose obligations in which gross proceeds of the issue are invested is less than the amount that would have been earned if the yield on such obligations had been equal to the yield on the issue, the issuer may not recover such deficit from an excess previously paid to the United States.

(4) *Examples.* The following examples illustrate the application of this paragraph (e):

Example (1). On January 1, 1985, Authority P issues a $10,000,000 issue of industrial development bonds to provide an airport as described in section 103 (b)(4)(D) and the regulations thereunder. No election is made to take earnings on the bona fide debt service fund into account in determining the amount required to be paid to the United States. The issue consists of variable rate obligations the interest on which is adjusted every 7 days according to an index prescribed in the bond indenture such that the yield over the term of the issue cannot be determined on the date of issue. P immediately loans the original proceeds of the issue ($9,900,000) to Corporation Z, the intended owner of the airport. In accordance with § 1.103–14 (b), Z places $8,800,000 of the original proceeds in a construction fund and invests those proceeds in nonpurpose obligations. The remainder of the original proceeds ($1,100,000) is used to fund a reasonably required reserve fund and is invested in nonpurpose obligations. A bona fide debt service fund, as defined in § 1.103–13(b)(12), will be maintained for the issue. On December 31, 1989, Z calculates that the aggregate amount earned on all nonpurpose obligations (other than nonpurpose obligations acquired with gross proceeds in the bona fide debt service fund and other than reinvestments of nonpurpose obligation receipts) is $1,200,000. The amount that would have been earned if the yield on all nonpurpose obligations (other than

reinvestment of nonpurpose obligation receipts) in which gross proceeds of the issue were invested had been equal to the yield on the issue is $1,000,000. The reinvestment of nonpurpose obligation receipts produced an additional $100,000 of income. During each of the years 1985 through 1988, the gross earnings on the bona fide debt service fund did not exceed $100,000. During 1989, however, the gross earnings on the bona fide debt service fund were $135,000. The amount that would have been earned if the nonpurpose obligations in which the gross proceeds in the bona fide debt service fund were invested during 1989 (other than reinvestment of nonpurpose obligation receipts) had been invested at a rate equal to the yield on the issue is $110,000. Thus, as of December 31, 1989, the amount described in paragraph (d)(1) (other than amounts that need not be taken into account under paragraph (d)(4)) is $325,000. In accordance with the requirements of paragraph (d) and (e), on January 15, 1990, Z pays $292,500 to the United States. As of January 15, 1990, Z has satisfied the requirements of section 103 (c)(6)(D) and paragraph (d).

Example (2). The facts are the same as in Example (1). During the period January 1, 1990, through December 31, 1994, interest rates increase significantly. As of December 31, 1994, the amount described in paragraph (d)(1) for the period January 1, 1985, through December 31, 1994 (other than amounts that need not be taken into account under paragraph (d)(4), is $260,000. Since Z has previously paid to the United States an amount in excess of $234,000 (90 percent of $260,000), Z need not make any payments to the United States on December 31, 1994, in order to comply with paragraph (d).

(f) *Exemption from gross income of sum rebated*—(1) *In general.* For all purposes of the Internal Revenue Code, gross income does not include the amount required to be paid to the United States under paragraph (d) of this section. The preceding sentence does not apply, however, to any amounts described in paragraph (d) that, by reason of paragraph (d) (4) or (5), are not required to be paid to the United States. Thus, for example, where the gross earnings on a bona fide debt service fund in any bond year is less than $100,000, such amount must be included in gross income. Notwithstanding any other provision of the Internal Revenue Code, no deduction shall be allowed for any amount paid to the United States under paragraph (d).

(2) *Calculation of exemption.* The determination of the amount excluded from gross income shall be made on an annual basis and must take into account the amounts excluded from or included in gross income during prior years. If the amount excluded from gross income is determined to exceed the amount required to be paid to the United States under paragraph (d), the excess must be included in gross income for the taxable year in which the revised determination is required to be made.

(3) *Example.* The following example illustrates the provisions of this paragraph:

Example. On January 1, 1986, Authority Q issues industrial development bonds to provide a facility described in section 103(b)(4)(E). The facility will be constructed and owned by M Corporation. Authority Q immediately loans the original proceeds of the issue to M. M is a calendar year taxpayer. For calendar year 1986 M determines that the amount that it would be required to pay to the United States under paragraph (d) is $25,000. M does not include this amount in gross income for calendar year 1986. M determines that as of December 31, 1987, the total amount that it would be required to pay to the United States under paragraph (d) is $20,000; this amount is based on a computation of the amount described in paragraph (d) for the period January 1, 1986, through December 31, 1987. The determination of the amount to be excluded from (or included in) M's gross income for calendar year 1987 must take into account the amount excluded from gross income for calendar year 1986. For calendar years 1986 and 1987, M should have excluded a total of $20,000 from gross income. Since M excluded $25,000 from gross income for calendar year 1986, M must include $5,000 in its gross income for 1987.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 103 (c) and 7805 of the Internal Revenue Code of 1954 (98 Stat. 922, 26 U.S.C. 103 (c); 68A Stat. 917, 26 U.S.C. 7805).

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

Approved: December 31, 1984.

Ronald A. Pearlman,

Acting Assistant Secretary of the Treasury.

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26 CFR Parts 1, 31, and 54

[T.D. 8004]

Taxation of Fringe Benefits

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations concerning the treatment of taxable and nontaxable fringe benefits. Changes to the applicable law were made by the Tax Reform Act of 1984. The regulations affect any person providing or receiving fringe benefits. The regulations provide these persons with the guidance necessary to comply with the law. In addition, the text of the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced in the Proposed Rules section of this issue of the Federal Register.

DATES: The regulations are effective as of January 1, 1985.

FOR FURTHER INFORMATION CONTACT: Annette J. Guarisco of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202) 566-3918 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary regulations relating to the treatment of taxable and nontaxable fringe benefits. Sections 61, 3121, 3231, 3306, 3401, 3501 of the Internal Revenue Code of 1954 (Code) were amended, and sections 132 and 4977 were added to the Code, by section 531 of the Tax Reform Act of 1984 (98 Stat. 877). The temporary regulations will remain in effect until superseded by final regulations on this subject.

Summary of Provisions

Due to the January 1, 1985, effective date of section 531 of the Tax Reform Act of 1984, there is need for immediate guidance regarding the amendments to the Code so that persons affected can make preparations to comply with the law. Therefore, these regulations have been drafted in question and answer format in order to facilitate their timely publication. No inference should be drawn, however, regarding issues not raised herein or regarding the inclusion of certain questions, and not others, in these regulations.

Section 61

Section 61 (a) (1), as amended, provides that, unless specifically excluded by some other section of the Code, gross income includes compensation for services, including fringe benefits. The regulations provide examples of includible and excludable fringe benefits, rules for determining in whose gross income the value of a fringe benefit is to be included, and general rules for determining the fair market value of a fringe benefit.

In addition, the regulations provide optional special valuation rules for employer-provided automobiles, use of employer-provided automobiles for commuting, flights on employer-provided airplanes, and free or discounted flights on commercial airlines. When properly applied, employers and employees may rely on these special valuation rules for purposes of income inclusion, withholding, and reporting in lieu of determining the actual fair market value of the fringe benefit.

Under the special rule for valuing the availability of employer-provided automobiles, Annual Lease Values and Daily Lease Values are provided to determine the amount includible in gross income. The Annual Lease Value, determined according to a table set forth in the regulations, is an estimate of the annual cost of leasing an automobile based on a four-year lease. The Daily Lease Value, determined by reference to the applicable Annual Lease Value, is an estimate of the daily cost of renting an automobile based on a day-to-day rental. The amount of the Annual Lease Value or the Daily Lease Value that is actually included in income depends on whether, and to what extent, such amount is subject to a statutory exclusion such as the working condition fringe exclusion (discussed below).

Under the special rules for valuing the use of employer-provided automobiles for commuting, an employer or employee may, under certain circumstances, value the commuting use of the automobile at $4.00 per day for each day of use.

Under the special rule for valuing flights on employer-provided airplanes, multiples of the applicable Standard Industry Fare Level (SIFL) rates may be used to determine the amount includible in gross income. The multiples and the SIFL rates are provided in the regulations. The multiples are intended to approximate commercial airline fares of, depending on the circumstances, 100 percent of coach and 300 percent of first class. The amount that is actually included in gross income depends on whether, and to what extent, such amount is subject to a statutory exclusion such as the working condition fringe exclusion (discussed below).

Under the special rule for valuing flights on commercial airlines, 50 percent of the actual carrier's highest unrestricted coach fare may be used as the value of the flight. This rule may be applied with respect to an individual, such as a parent of an airline employee, the value of whose flight is generally includible in the airline employee's income.

The special rules may be used by both employers and employees. Generally, neither the employer not the employee is bound by the other's use of the special rules. If the special rules are used, however, there are certain consistency requirements that apply to the person using them.

Section 132

Section 132, as added to the Code, provides that certain fringe benefits are excludable from gross income if they qualify as no-additional-cost services, qualified employee discounts, working condition fringes, or de minimis fringes. The regulations provide guidance relating to the definition and application of the working condition fringe exclusion, the application of the line of business restriction for purposes of the no-additional-cost service and qualified employees discount exclusions, and rules relating to discriminatory fringe benefit plans and the definition of a highly compensated employee.

The working condition fringe exclusion applies to any property or service provided to an employee to the extent that, if the employee paid for such property or service, the payment would be allowable as a deduction under section 162 or 167. The regulations provide examples describing the application of the working condition fringe exclusion to the availability of employer-provided automobiles and flights on employer-provided airplanes.

In general, if the use of an automobile is provided to an employee, the amount of the working condition fringe is determined by multiplying the fair market value of the availability of the automobile (Annual Lease Value or Daily Lease Value under the special rules described above) by a fraction, the numerator of which is the employee's business-use mileage and the denominator of which is the empolyee's total mileage. If an employee flies on the employer's airplane primarily for business reasons, the value of the employee's flight would be excludable as a working condition fringe.

The regulations also address the application of the working condition fringe to employer-provided automobiles and flights on employer-provided airplanes when business-oriented security concerns exist. In general, only the value, if any, of the automobile or flight on the airplane directly attributable to the business-oriented security concerns will qualify for the working condition exclusion.

The regulations provide rules concerning the nondiscrimination rules of section 132. In particular, the regulations define a highly compensated employee, for purposes of certain fringe benefit exclusions, as any employee who has compensation greater than the compensation of 90 percent of all employees employed by the employer. In addition, any employee who has compensation of $50,000 or more is a highly compensated employee and any employee who has compensation of $20,000 or less is generally not a highly compensated employee.

The regulations also provide guidance relating to the line of business restriction applicable to no-additional-cost services and qualified employee discounts. In general, such fringe benefits are not excludable pursuant to section 132 if the property or service being provided is not a property or service offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services.

Income and Employment Tax Withholding

Sections 3121, 3231, 3306, 3401, and 3501, as amended, generally provide that fringe benefits that are not otherwise specifically excluded from gross income pursuant to the applicable section are includible in wages and compensation for purposes of income and employment tax withholding and for purposes of employment taxes. In general, the regulations provide that employers may deem any noncash fringe benefit provided in a calendar quarter as provided no later than the last day of the calendar quarter. A special rule applies with respect to noncash fringe benefits provided in the first calendar quarter of 1985, i.e., employers may deem any benefit provided in the first calendar quarter as provided in the second calendar quarter of 1985. The employer may treat the payment of any noncash fringe benefit as a payment of supplemental wages. Consequently, it is subject to withholding at a flat 20 percent rate.

Section 4977

Section 4977, as added to the Code, provides an elective grandfather rule that allows employers under certain circumstances to treat employees of all lines of business which were in existence on January 1, 1984, as employees of one of those lines of business for purposes of the exclusions for no-additional-cost services and qualified employee discounts.

Special Analyses

The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as

defined in Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexbility Act does not apply and a Regulatory Impact Analysis is not required for this rule.

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB. Control number [1545-0907].

Drafting Information

The principal author of these regulations is Annette J. Guarisco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

List of Subjects

26 CFR 1.61-1—1.281-4

Income taxes, Taxable income, Deductions, Exemptions.

26 CFR Part 31

Employment taxes, Income taxes, Lotteries, Railroad Retirement, Social Security, Unemployment taxes, Withholding.

26 CFR Part 54

Excise taxes, Pensions.

Adoption of Amendment to the Regulations

Accordingly, 26 CFR Parts 1, 31, and 54 are amended as follows:

PART 1—[AMENDED]

Paragraph 1. The following new § 1.61-2T is added after § 1.61-2 to read as follows:

§ 1.61-2 Questions and answers relating to the taxation of fringe benefits (Temporary).

The following questions and answers relate to the taxation of fringe benefits pursuant to section 61(a)(1) of the Internal Revenue Code of 1954, as amended by section 531(c) of the Tax Reform Act of 1984 (98 Stat. 885):

In General

Q-1: Section 61(a)(1) provides that fringe benefits are includible in gross income unless specifically excluded pursuant to another section of the Code. What are examples of such fringe benefits?

A-1: Examples of such fringe benefits are: an employer-provided automobile; a flight on an employer-provided airplane; an employer-provided free or discounted commercial airline flight; an employer-provided vacation; an employer-provided discount on property or services; an employer-provided membership in a country club or other social club; and an employer-provided ticket to an entertainment event.

A fringe benefit may be excluded from gross income, however, pursuant to a specific statutory provision of the Code, such as section 132(a) (3) and (4) excluding working condition fringes and de minimis fringes. See also § 1.132-1T.

Q-2: How do the rules of section 61 and the regulations thereunder operate if the tax treatment of a particular fringe benefit is specifically addressed in another section of the Code?

A-2: If the tax treatment of a particular fringe benefit is specifically addressed in another Code section, that section governs the treatment of the fringe benefit, and section 61 and the regulations thereunder apply only to the extent that they are not inconsistent with such other section of the Code.

Many fringe benefits specifically addressed in other sections of the Code are excluded from gross income only to the extent that they do not exceed specific dollar or percentage limits, or only if certain other requirements are met. If the limits are exceeded or the requirements are not met, some or all of the fringe benefit may be includible in gross income (see also Q/A-7 of this section).

Q-3: In whose gross income is the value of a fringe benefit includible?

A-3: A fringe benefit provided to any person in connection with the performance of services by such person is includible in such person's gross income. Refraining from the performance of services (such as pursuant to a covenant not to compete) is deemed to be the performance of services for purposes of this section.

If a fringe benefit is provided to any person in connection with the performance of services by another person, the fringe benefit is considered for tax purposes to have been provided to the person who performs the services, not the person who receives the fringe benefit. Any reference in this section to the "recipient" of a fringe benefit is a reference to the person performing the services in connection with which the fringe benefit is provided.

Q-4: When is this section effective?

A-4: This section is effective as of January 1, 1985. No inference may be drawn from the promulgation or terms of this section concerning the application of law in effect prior to January 1, 1985.

Valuation of Taxable Fringe Benefits—In General

Q-5: What amount must the recipient of a fringe benefit include in gross income?

A-5: The recipient of a fringe benefit must include in gross income the amount by which the fair market value of the fringe benefit exceeds the sum of (a) the amount, if any, paid for the benefit, and (b) the amount, if any, specifically excluded from gross income by some other section of the Code. The fair market value of a fringe benefit is determined on the basis of all the facts and circumstances.

Q-6: Is the recipient's subjective perception of the value of a fringe benefit relevant to the determination of the fair market value of the fringe benefit?

A-6: No. The fair market value of a fringe benefit is determined on the basis of objective facts and circumstances.

Q-7: Is the cost incurred by an employer (or other provider of a fringe benefit) in providing a fringe benefit determinative of the fair market value of the fringe benefit?

A-7: No. The fair market value of a fringe benefit must be determined without regard to whether such amount is equivalent to the cost incurred by the employer (or other provider of a fringe benefit) in providing such fringe benefit. However, if a statutory exclusion phrased in terms of employer cost applies to the provision of a fringe benefit, section 61 does not require the inclusion in the recipient's gross income of the difference between the fair market value and excludable cost of that fringe benefit. For example, section 129 provides an exclusion from an employee's gross income for amounts paid or incurred by an employer to provide dependent care assistance to employees. Even if the fair market value of the dependent care assistance

exceeds the employer's cost, the excess is not subject to inclusion under section 61. If the statutory cost exclusion is a limited amount, however, then the fair market value of the fringe benefit attributable to any excess cost is subject to inclusion.

Q–8: What amount may an employer deduct as compensation paid to an employee when a fringe benefit is provided to an employee?

A–8: The amount an employer may deduct as compensation paid to an employee is determined under section 162 and the regulations thereunder. In particular, see § 1.162–25T.

Valuation of Taxable Fringe Benefits—Special Rules

Q–9: Are there any special rules that taxpayers may use to value certain commonly provided fringe benefits?

A–9: Yes. There are special rules for valuing employer-provided automobiles (Q/A–11 through Q/A–19 of this section), use of employer-provided automobiles for commuting (Q/A–20a through Q/A–22c of this section), flights on employer-provided airplanes (Q/A–23 through Q/A–29 of this section), and free or discounted flights on commercial airplines (Q/A–30 through Q/A–34 of this section). The special rules for valuation may be used in connection with the provision of a fringe benefit to or on behalf of any person properly taxed on account thereof, and, except as otherwise provided in Q/A–9 through Q/A–34, any reference in Q/A–9 through Q/A–34 to "employee" includes a reference to any such person, as applicable.

The special rules may be used by the employer or employee for income, employment tax, and reporting purposes. Neither the employer nor the employee is bound by the other's use of a special rule. If a special rule is used, however, certain consistency requirements apply to the employer and to the employee. See Q/A–19, 22, 28, and 34 of this section.

Q–10: For purposes of Q/A–9 through Q/A–34, except as otherwise provided therein, does the term "employer" include all employers treated as a single employer under section 414 (b), (c), or (m)?

A–10: Yes.

Valuation of the Availability of Employer-Provided Automobiles

Q–11: For purposes of Q/A–11 through Q/A–19 of this section, what does the term "automobile" mean?

A–11: The term "automobile" means any four-wheeled vehicle which is manufactured primarily for use on public streets, roads, and highways.

Q–12: What is the special rule for valuing the availability to an employee of an employer-provided automobile?

A–12: If an employer provides an employee with an automobile which is available to the employee for an entire calendar year, the Annual Lease Value (as defined in Q/A–13 of this section) is the value of the benefit provided. An automobile available to or used by an individual, but taxable to an employee (see Q/A–3 of this section), is referred to in Q/A–11 through Q/A–19 of this section as available to the employee and use by the individual is considered use by the employee. For a discussion of the working condition fringe exclusion relating to the business use of an employer-provided automobile, see section 132 (a)(3) and § 1.132–1T.

When the special rule is not used, the value of the availability of an employer-provided automobile is determined under the general valuation principles set forth in this section. In general, such valuation must be determined by reference to the cost to the employee of renting or leasing a comparable automobile on comparable terms for a comparable period. The value of the availability of an employer-provided automobile cannot be determined by reference to a cents-per-mile rate applied to the number of miles the automobile is driven.

Q–13: What is Annual Lease Value?

A–13: The Annual Lease Value of a particular automobile is determined as follows:

(a) *Fair market value.* To calculate the Annual Lease Value for an employer using the special rule, determine the fair market value of the automobile, without regard to any group or volume discount, as of the first date on which the automobile is made available to any employee of the employer for personal use. For an automobile made available to an employee for personal use prior to January 1, 1985, determine the fair market value as of January 1, 1985.

If the employer is not using the special rule, the employee may calculate the Annual Lease Value by determining the fair market value of the automobile as of the first date on which the automobile is made available to the employee for personal use or, for an automobile made available to an employee for personal use prior to January 1, 1985, by determining the fair market value as of January 1, 1985. If the employer is using the special rule, however, then the employee may use the special rule only if such use is consistent with the employer's use. Thus, if an employer uses the special rule with respect to an automobile, the employee to whom the automobile is made available must use the special rule, if at all, by including the same amount in income as the amount included in the employee's income by the employer.

(b) *Annual Lease Value.* Select the dollar range in column 1 of the table set forth below, corresponding to the fair market value determined in (a). Except as otherwise provided in this Q/A–13, the Annual Lease Value for each year of availability is the corresponding amount in column 2 of the table.

ANNUAL LEASE VALUE TABLE

Automobile fair market value	Annual lease value
(1)	(2)
$0 to 999	$600
1,000 to 1,999	850
2,000 to 2,999	1,100
3,000 to 3,999	1,350
4,000 to 4,999	1,600
5,000 to 5,999	1,850
6,000 to 6,999	2,100
7,000 to 7,999	2,350
8,000 to 8,999	2,600
9,000 to 9,999	2,850
10,000 to 10,999	3,100
11,000 to 11,999	3,350
12,000 to 12,999	3,600
13,000 to 13,999	3,850
14,000 to 14,999	4,100
15,000 to 15,999	4,350
16,000 to 16,999	4,600
17,000 to 17,999	4,850
18,000 to 18,999	5,100
19,000 to 19,999	5,350
20,000 to 20,999	5,600
21,000 to 21,999	5,850
22,000 to 22,999	6,100
23,000 to 23,999	6,350
24,000 to 24,999	6,600
25,000 to 25,999	6,850
26,000 to 27,999	7,250
28,000 to 29,999	7,750
30,000 to 31,999	8,250
32,000 to 33,999	8,750
34,000 to 35,999	9,250
36,000 to 37,999	9,750
38,000 to 39,999	10,250
40,000 to 41,999	10,750
42,000 to 43,999	11,250
44,000 to 45,999	11,750
46,000 to 47,999	12,250
48,000 to 49,999	12,750
50,000 to 51,999	13,250
52,000 to 53,999	13,750
54,000 to 55,999	14,250
56,000 to 57,999	14,750
58,000 to 60,999	15,250

For vehicles having a fair market value in excess of $60,000, the Annual Lease Value is equal to:
(.25 × automobile fair market value) + $500.

(c) *Determination of Annual Lease Value after fourth year.* Except as otherwise provided in (d), the figures in the Table are the Annual Lease Values for the period starting on the first date on which the special rule is applied by the employer or the employee to the automobile, and ending on December 31 of the fourth full year following that date. The Annual Lease Value for each of the subsequent calendar years is determined by taking the fair market value of the automobile on the January 1

following the period described in the previous sentence and selecting the amount in column 2 of the Table corresponding to the appropriate dollar range in column 1 of the Table.

(d) *Transfer of automobile to another employee.* If, for bona fide business reasons, the employer transfers the automobile from one employee to another employee, the employer may redetermine the Annual Lease Value based upon the fair market value of the automobile on January 1 of the year of transfer. The Annual Lease Value may not be redetermined upon transfer of the automobile if the purpose for the transfer is the reduction of federal taxes.

Q–14: Are maintenance of and insurance for an employer-provided automobile included in the Annual Lease Value determined pursuant to Q/A–13 of this section?

A–14: Yes.

Q–15: Is fuel provided in kind by an employer included in the Annual Lease Value determined pursuant to Q/A–13 of this section?

A–15: No. The Annual Lease Value does not include fuel provided in kind by an employer. The provision of fuel in kind may be valued separately at fair market value based upon all the facts and circumstances, or in the alternative, it may be valued at 5.5 cents per mile for all miles driven by the employee.

Q–16: Is provision by the employer of any service with respect to an automobile not specifically identified in Q/A–14 of this section, such as the services of a chauffeur, included in the Annual Lease Value determined pursuant to Q/A–13 of this section?

A–16: No. The provision of the services of a chauffeur or other service must be valued separately at fair market value based upon all the facts and circumstances.

Q–17: May the special rule be used to value the availability of automobiles in countries other than the United States?

A–17: No, unless the automobile is physically located in the United States for substantially all of the calendar year.

Q–18: May the special rule be used to value the availability of an employer-provided automobile if such automobile is available to the employee for less than the entire calendar year?

A–18: Yes, subject to the following conditions:

(a) *Continuous availability of at least 30 days.* Except as otherwise provided in (d) of this Q/A–18, for periods of continuous availability of at least 30 days, but less than an entire calendar year, the value of the employer-provided automobile is determined by using a pro-rated Annual Lease Value, computed by multiplying the Annual Lease Value by a fraction, the numerator of which is the number of days of availability and the denominator of which is 365.

(b) *Continuous availability of less than 30 days—Daily Lease Value.* Except as otherwise provided in (c) of this Q/A–18, for periods of continuous availability of one or more but less than 30 days, the Daily Lease Value must be used. The Daily Lease Value equals the Annual Lease Value multiplied by a fraction, the numerator of which is four times the number of days of availability and the denominator of which is 365.

(c) *Election to treat all periods as periods of at least 30 days.* A pro-rated Annual Lease Value may be applied with respect to a period of continuous availability of less than 30 days, by treating the automobile as if it had been available for 30 days, if to do so would result in a lower valuation than applying the Daily Lease Value to the shorter period of actual availability.

(d) *Periods of unavailability.* In general, a pro-rated Annual Lease Value (as provided in (a) of this Q/A–18) may be used to value the availability of an employer-provided automobile to an employee for a period of continuous availability of at least 30 days but less than the entire calendar year. However, a pro-rated Annual Lease Value may not be used to the extent any periods for which the employer-provided automobile is not available to the employee are not attributable to bona fide business reasons of the employer. The fact that an automobile is unavailable because the employee is on a personal vacation is not a bona fide business reason of the employer for unavailability. For example, assume an automobile is available to an employee during the first five months of the year and during the last five months of the year. The period of unavailability occurs because the employee is on a personal vacation. The Annual Lease Value, if it is applied, must be applied with respect to the entire twelve-month period. The Annual Lease Value may not be pro-rated to take into account the two-month period of unavailability.

Q–19: What rules govern the adoption and application of the special rule?

A–19: (a) Use of the special rule is optional. Neither the employer nor the employee is bound by the other's use of the special rule.

(b) An employer may adopt the special rule for an automobile only if such rule is adopted with respect to the first calendar quarter in which the automobile is made available to an employee of the employer for personal use. For an automobile made availabele to an employee for personal use prior to January 1, 1985, the special rule must be adopted with respect to the first quarter of 1985.

Once the special rule has been adopted for an automobile by an employer, the rule must be used by the employer for all years in which the employer makes such automobile available to any employee, and such rule must be used for all purposes with respect to the automobile.

(c) An employee may adopt the special rule for an automobile only if such rule is adopted with respect to the first calendar year in which the automobile is made available to the employee for personal use. For an automobile made available to the employee for personal use prior to January 1, 1985, the special rule may be used by the employee only if it is adopted with respect to 1985.

Once the special rule has been adopted for an automobile by an employee, the rule must be used by the employee for all years in which the automobile is available to the employee, and such rule must be used for all purposes with respect to the automobile.

(d) If the special rule is used by an employer and/or employee with respect to an automobile and a different automobile is provided to the employee for the purpose of reducing Federal taxes, then the employer and/or employee using the special rule must continue to use the rule with respect to such different automobile.

Use of Employer-Provided Automobiles for Commuting

Q–20: Is there a special rule that taxpayers may use to value employer-provided automobiles which are not available for personal use other than commuting use?

A–20: A special rule may be used to compute commuting value if the following criteria are met with respect to an employer-provided automobile:

(a) For bona fide, noncompensatory business reasons, the employer requires the employee to commute in the automobile,

(b) The employer's policy is that the employee is not allowed to use the automobile for personal purposes other than commuting,

(c) Except for de minimis use, the employee does not use the automobile for any personal purpose other than commuting,

(d) The automobile is used in the employer's business,

(e) Except in the case of police, fire, and emergency medical vehicles, a substantial amount of the use of the automobile in the employer's business is

by employees other than the employee required to use the automobile for commuting, and

(f) The employee required to use the automobile for commuting is not a key employee (as defined in Q/A–26 of this section).

Q–21: If the requirements of Q/A–20 of this section are satisfied, what is the special rule for valuing the commuting in the employer-provided automobile?

A–21: Under the special rule, the commuting is valued at $4.00 per day for each day the automobile is used for commuting (either one-way or round-trip).

Q–22: What rules govern the adoption and application of the special rule?

A–22: (a) Use of the special rule is optional.

(b) For any calendar year, adoption of the special rule by the employee must be made with respect to all commuting in the calendar year which qualifies for use of the special rule.

(c) For any calendar year, adoption of the special rule by the employer with respect to any employee must be made with respect to all commuting by such employee in the calendar year which qualifies for use of the special rule.

Valuation of Flights on Employer-Provided Airplanes

Q–23: What is the special rule for valuing a flight by an employee on an employer-provided airplane?

A–23: If an employee is provided with a flight on an employer-provided airplane, multiples of the applicable Standard Industry Fare Level ("SIFL") rates are used to value the flight by applying the following formula: (applicable SIFL multiple in Q/A–25 of this section × ($.1480 per mile for the first 500 miles, $.1128 per mile for miles between 501 and 1500, and $.1065 per mile for miles over 1500)) + a terminal charge of $27.05. For example, the value of a one-way flight which is 2,000 miles would equal $27.05 + (the applicable SIFL multiple in Q/A–25 of this section × (($.1480×500) + ($.1128×1,000) + ($.1085×500))). The value of a round-trip flight which is 2,000 miles each way would equal twice the value determined in the preceding sentence.

The numbers in the preceding paragraph reflect the SIFL rates in effect on December 31, 1984. To determine the SIFL rates in effect for the date of a particular flight, see Q/A–24 of this section.

The special rule may not be used to value a flight on an airplane on which the employer offers, in the ordinary course of its business, air transportation to customers. In addition, the special rule may not be used to value a flight by a key employee (as defined in Q/A–26 of this section) if there is no business purpose for the trip by the airplane. For rules relating to the valuation of such a flight, see Q/A–29 of this section.

For purposes of Q/A–23 through Q/A–29 of this section, a flight provided to an individual whose flight would be taxed to the employee (such as the employee's spouse, see Q/A–3 of this section) is referred to as being provided to the employee, and a flight taken by such individual is considered a flight taken by the employee. For a discussion of the working condition fringe exclusion for a flight on an employer-provided airplane, see section 132 (a) (3) and § 1.132–1T.

Q–24: What is SIFL?

A–24: SIFL is a per-mile formula rate, revised periodically, calculated by the Department of Transportation beginning January 1, 1985. Prior to that date, the Civil Aeronautics Board calculated the SIFL rates. For purposes of this section, in determining the value of a particular flight during the first six months of a calendar year, the SIFL rates in effect on December 31 of the preceding year apply, and in determining the value of a particular flight during the last six months of a calendar year, the SIFL rates in effect on June 30 of that year apply.

Q–25: What are the appropriate SIFL multiples for purposes of Q/A–23 of this section?

A–25: The appropriate SIFL multiples are as follows:

(a) 125 percent of the SIFL rates for any flight by any employee who is not a key employee (as defined in Q/A–26 of this section).

(b) 125 percent of the SIFL rates for a flight by a key employee if there is a primary business purpose for the trip by the airplane. For purposes of this (b), entertaining an employee or other individual is not a business purpose.

(c) 600 percent of the SIFL rates for a flight by a key employee if there is no primary business purpose for the trip by the airplane. Where there is no business purpose for the trip by the airplane, the special rule may not be used to value a flight by a key employee. See Q/A–29 of this section for rules concerning flights by key employees on such trips. For purposes of this section, compensating an employee is not a business purpose.

The value of a flight derived from these multiples applies on a passenger by passenger basis. For example, if an individual accompanies an employee, and the flight taken by the individual would be taxed to the employee, the employee would be taxed on the special rule value of his flight and on the special rule value of the flight taken by the individual accompanying him. If an employee is a key employee, any individual whose flight would be taxed to the employee (such as the employee's spouse), see Q/A–3 of this section, is also considered a key employee for purposes of the special rule.

Q–26: Who is a "key employee" for purposes of determining the value of flights on employer-provided airplanes under the special rule?

A–26: A "key employee" is any employee who is a five-percent owner or an officer of the employer, or who, with respect to a particular trip by the airplane, controls the use of the airplane. For purposes of determining who is a five-percent owner, any individual who owns (or is considered as owning) more than five-percent of the fair market value of an entity (the "owned entity") is considered a five-percent owner of all entities which would be aggregated with the owned entity under the rules of section 414 (b), (c), or (m).

Q–27: For what types of flights may the special rule be used?

A–27: The special rule may only be used for the following types of flights on employer-provided airplanes:

(a) Flights that originate and terminate in the United States; or

(b) Flights that originate in the United States and terminate in Canada (or vice versa); or

(c) Flights that originate in the United States and terminate in Mexico (or vice versa).

Q–28: What rules govern the adoption and application of the special rule?

A–28: (a) Use of the special rule is optional. An employee is not bound by an employer's use of the special rule for wage withholding and employment tax purposes, and an employer who does not use the special rule is not bound by an employee's use thereof.

(b) The special rule, if adopted by an employer or employee for any calendar year, must be used by the person adopting such rule for all flights either provided by the employer or taken by the employee, in such calendar year which qualify for use of the special rule, and must be used for all purposes for each such flight.

(c) If the special rule is used by an employer or a key employee, as the case may be, on the ground that either

(1) the key employee is not in fact a key employee, or

(2) an airplane trip had a primary business purpose, or

(3) an airplane trip had some business purpose, and that position is determined to be erroneous, the special rule may not thereafter be used with respect to that flight taken by that key employee by the

person or persons previously taking the erroneous position.

Q-29: What is the value of a flight on an employer-provided airplane if for any reason the special rule is not or cannot be used?

A-29: The value of such a flight is the fair market value determined on the basis of all the facts and circumstances. For example, if an employee controls the use of the airplane on a trip with no business purpose, such flight is valued by reference to the cost of chartering a similar airplane for a similar trip. The result would be the same if there were some (but not a primary) business purpose and the special rule was not used or could not be used. The charter cost must be apportioned equally among all passengers on the flight, excluding employees who are not key employees.

Valuation of Free or Discounted Commercial Airline Flights

Q-30: Are free or discounted commercial airline flights by parents of an airline employee includible in the gross income of the employee?

A-30: Yes. Section 61 includes the fair market value of such flights as a fringe benefit. The employee is taxed on the benefit, since it is provided in connection with the performance of services by the employee.

The value of a flight by a parent of an airline employee is not eligible for the no-additional-cost service exclusion provided by section 132(a)(1) with respect to flights by airline employees, as defined in section 132(f)(1), and with respect to flights by spouses and dependent children of airline employees under section 132(f)(2). This Q/A-30 applies equally to flights provided to other guests, as defined in Q/A-32 of this section, of employees.

Q-31: What date is relevant for application of section 61(a)(1) and this section to a free or discounted flight on a commercial airline?

A-31: The relevant date is the date of the flight. The date of purchase or issuance of a pass or ticket is not relevant. Thus, this section applies to a flight taken on or after January 1, 1985, regardless of the date on which the pass or ticket for the flight was purchased or issued.

Q-32: What is the special rule for valuing taxable fringe benefit flights on a commercial airline by airline employees or their guests?

A-32: A flight—

(a) provided on an airplane on which the employer offers, in the ordinary course of business, transportation to customers,

(b) for which the airline, by carrying an employee or guest of the employee, incurs no substantial additional cost (including forgone revenue) determined without regard to any amount paid for such flight (i.e., the employee or guest flies on a "stand-by basis"), and

(c) which is subject to the types of restrictions customarily associated with flying on an employee stand-by basis,

is valued at 50% of the actual carrier's highest unrestricted coach fare in effect for the particular flight being valued.

For purposes of Q/A-30 through Q/A-34 of this section, a guest of an employee is an individual whose free or discounted flight would be taxed to the employee (see Q/A-3 of this section).

Q-33: Does the special rule apply to flights by an employee or an employee's guest on a nonemployer airline pursuant to a reciprocal agreement between the employer and the actual carrier?

A-33: The special rule may be used for such a flight only if the flight is one which would meet the conditions of Q/A-32 if the actual carrier were the employer.

Q-34: What rules govern the adoption and application of the special rule?

A-34: (a) Use of the special rule is optional. An employee is not bound by an employer's use of the special rule for wage withholding and employment tax purposes, and an employer who does not adopt the special rule is not bound by an employee's use thereof.

(b) The special rule, if adopted by an employer or employee for any calendar year, must be used for all flights either provided by the employer or taken by the employee in such calendar year which qualify for use of the special rule, and must be used for all purposes for each such flight.

Par. 2. The following new section is added after § 1.127-2 and reads as follows:

§ 1.132-1T Questions and answers relating to the exclusion from gross income of certain fringe benefits (temporary).

The following questions and answers relate to the exclusion from gross income of certain fringe benefits pursuant to section 531(a) of the Tax Reform Act of 1984 (98 Stat. 878):

In General

Q-1: What does section 132(a) provide?

A-1: Section 132 provides an exclusion from gross income for any fringe benefit that qualifies as a—

(a) No-additional-cost service,

(b) Qualified employee discount,

(c) Working condition fringe, or

(d) De minimis fringe.

Line of Business

Q-2: What is the line of business limitation of sections 132(b) and 132(c)(4)?

A-2: A service provided to or on behalf of an employee does not qualify as a no-additional-cost service under section 132(b) unless the service is offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services. Similarly, a discount does not qualify as a qualified employee discount under section 132(c)(4) unless the property or service is offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services. See section 4977 and § 1.4977-1T for a transitional election relating to the line of business limitation.

Working Condition Fringe

Q-3: What is a working condition fringe?

A-3: A working condition fringe is any property or services provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under section 162 or 167. If the hypothetical payment would be allowable as a deduction with respect to a trade or business of the employee, which is unrelated to the employer's trade or business, such payment will not be deemed allowable as a deduction for purposes of determining the amount, if any, of the working condition fringe.

Q-4: How does the working condition fringe exclusion apply to availability of an employer-provided automobile?

A-4: In general, the amount excludable as a working condition fringe is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the availability of the automobile. For purposes of this section, use by an individual of an automobile whose availability to the individual would be taxed to an employee is included in references to use by the employee.

For example, assume the value of the availability for a full year of an employer-provided automobile is $2,000, without regard to any working condition fringe (i.e., assuming all non-business use). Assume further that the employee drives the automobile 6,000 miles for his employer's business and 2,000 miles for non-business reasons. In this situation the value of the working condition fringe is $2,000 multiplied by a fraction, the numerator of which is the business-use

mileage (6,000 miles) and the denominator of which is the total use mileage (8,000 miles). Thus, the value of the working condition fringe is $1,500. The total amount includible in gross income by the employee on account of the availability of the automobile is $500. In determining business and total use mileage, only mileage driven by the employee is counted.

Q–5: In determining the amount, if any, of an employee's working condition fringe, do section 280F and the regulations thereunder apply?

A–5: No. For example, assume that employee A has available for a calendar year an employer-provided automobile which has a fair market value of $28,000. Assume further that the Annual Lease Value, as defined in § 1.61–2T, is $7,750 and that all of the employee's use of the automobile during the calendar year is in the employer's business. The employee would be entitled to exclude the entire Annual Lease Value as a working condition fringe, despite the fact that if the employee paid for the use of the automobile, an income inclusion would be required under § 1.280F–5T(d)(1). This Q/A–5 does not affect the applicability of section 280F to the employer with respect to such employer-provided automobile, nor does it affect the applicability of section 274.

Q–6: How does the working condition fringe exclusion apply to an employee who uses different employer-provided automobiles during the year?

A–6: The rule applies on an automobile by automobile basis. For example, assume automobile Y is available to employee D for 3 days in January and for 5 days in March, and automobile Z is available to D for a week in July. Assume further that the Daily Lease Value, as defined in § 1.61–2T, of each automobile is $50. For the eight days of availability of Y in January and March, D uses Y 90 percent for business (by mileage). During July, D uses Z 60 percent for business (by mileage). The value of the working condition fringe is determined separately for each automobile. Therefore, the working condition fringe for Y is $360 ($400 x .90) leaving an income inclusion of $40. The working condition fringe for Z is $210 ($350 x .60) leaving an income inclusion of $140. In determining business and total use mileage, only mileage driven by the employee is counted.

Q–7: How does the working condition fringe exclusion apply to specially designed automobiles which are provided by an employer for business-oriented security reasons?

A–7: The value of the working condition fringe is the amount which would be allowable as a deduction under section 162 or 167 if the employee paid for the availability of the specially designed automobile. For example, assume that for bona fide business-oriented security reasons an employer provides employee P with an automobile specially designed for security. Assume further that P uses the automobile only for personal use during the year. If P paid for the availability of the automobile, P would have been able to deduct no more than the excess of the amount P paid over the lesser amount P would have paid for the same mode of transportation absent the business-oriented security reasons. Thus, the includible amount would be not less than the value of the availability of the automobile without the special security design.

Q–8: If an employer provides an employee with an expensive automobile for the employee's personal purposes and the choice to provide an expensive rather than an inexpensive automobile is made by the employer for bona fide, noncompensatory business reasons, how does the working condition fringe rule apply?

A–8: There would be no working condition fringe with respect to the personal miles driven by the employee. If the employee had paid for the automobile he would not have been able to deduct any part of the payment attributable to personal miles.

Q–9: How does the working condition fringe exclusion apply to a flight on an employer-provided airplane?

A–9: If employee S flies on S's employer's airplane primarily for business reasons of S's employer, the value of S's flight is excludable as a working condition fringe. However, if S's spouse and children accompany S on such airplane trip for primarily personal reasons, the value of the flights by S's spouse and children is includible in S's gross income.

Q–10: How does the working condition fringe rule apply to flights on an employer-provided airplane for business-oriented security reasons?

A–10: The value of the working condition fringe is the amount that would be allowable as a deduction under section 162 or 167 if the employee paid for the flight. For example, assume that for bona fide business-oriented security reasons an employer provides an employee with a flight on an employer-provided airplane. Assume further that the flight is provided to the employee for personal purposes. If the employee paid for the flight, the employee would have been able to deduct no more than the excess of the amount paid over the lesser amount the employee would have paid absent the business-oriented security reasons. Thus, the includible amount would be not less than the amount the employee would have paid absent the security concern.

Q–11: Assume that an employer provides a flight to an employee on an employer-provided airplane and that the employer and/or the employee take the position on a return that the value of the flight is not includible in the employee's income because the purpose of the employee's flight was primarily business. If it is subsequently determined that the primary purpose of the employee's flight was personal, how is the flight valued?

A–11: The value of the flight is determined under the general valuation principles set forth in § 1.61–2T. The special valuation rules set forth in § 1.61–2T cannot be used. Similarly, if an employer and/or employee improperly take the position on a return that, due to a security concern, part or all of the value of a personal flight by an employee on an employer-provided airplane is excluded from gross income, the person who has improperly taken that position cannot use the special valuation rule provided in § 1.61–2T with respect to such flight by such employee.

For purposes of this Q/A–11, a flight by any individual whose flight would be taxed to the employee is treated as a flight by the employee (see § 1.61–2T).

Discrimination

Q–12: If an employer establishes separate fringe benefit plans or arrangements, will each plan be judged separately with respect to whether the plan discriminates in favor of officers, owners, or highly compensated employees ("prohibited group")?

A–12: Whether the separate fringe benefit plans will be judged separately depends upon the facts and circumstances. For example, assume a department store provides a 20 percent merchandise discount to all employees under one fringe benefit plan. Under a separate fringe benefit plan, the department store provides an additional 15 percent merchandise discount to a group of employees defined under a classification which discriminates in favor of the prohibited group. In this case, each plan would not be judged separately with respect to whether it is discriminatory. Instead, the plans would be considered together for purposes of testing for discrimination. Since considered together such plans would be discriminatory, section 132(a)(2) (relating to qualified employee

discounts) would not apply to the prohibited group members who are participants in both plans, so that no exclusion would be available for such employees with respect to either plan. Therefore, the entire 35 percent merchandise discount provided to the prohibited group members is includible in such employees' gross incomes.

Q–13: How are employer-provided cash bonuses or rebates provided to the prohibited group, which are adjusted according to the amount of purchases made by the employee, treated under section 132?

A–13: Such bonuses or rebates are treated as equivalent discounts. For example, assume all employees of an employer are provided a 20 percent discount with respect to all merchandise. In addition, the employer provides cash bonuses to a group of employees defined under a classification which discriminates in favor of the prohibited group. Assume further that such cash bonuses are equal to 15 percent of the value of merchandise purchased by each such employee. Such a structure would be treated exactly as the example in Q/A–12 of this section, and the prohibited group members who receive the cash bonuses may not exclude the 20 percent discount.

Q–14: Who is a highly compensated employee for purposes of section 132 and this section?

A–14: Except as otherwise provided below, any employee who has compensation greater than the compensation of 90 percent of all employees employed by the employer is a highly compensated employee. There are two exceptions to this rule:

(a) any employee who has compensation of $50,000 or more during a calendar year is a highly compensated employee for that year, regardless of whether his compensation is greater than the compensation of 90 percent of all employees employed by the employer, and

(b) any employee who has compensation of $20,000 or less during a year is not a highly compensated employee for that year, unless no employee of the employer has compensation in excess of $35,000.

The term "compensation" is defined as the amount which would be reported on a Form W–2 as compensation (excluding amounts that would be excludable but for section 132(h)(1)) for the calendar year. Compensation includes amounts received from all entities which would be treated as a single employer under section 414 (b), (c), and (m) and is not restricted to amounts received with respect to any one line of business.

Q–15: For purposes of Q/A–14 of this section, what is the meaning of the term "employee"?

A–15: Generally, for purposes of Q/A–11 of this section, the term "employee" does not include any individual who does not perform services for the employer as an employee during the calendar year. For example, if an employer has active employees, retired employees, and widows or widowers who are "employees" under section 132(f)(1)(B), the 90 percent test and the second exception to the 90 percent test (as listed in Q/A–14 of this section) apply only to the active employees.

Par. 3. The following new section is added after § 1.162–24 and reads as follows:

§ 1.162–25T Question and answer relating to compensation deductions with respect to noncash fringe benefits (Temporary).

The following question and answer relates to compensation deductions with respect to noncash fringe benefits pursuant to section 162 of the Internal Revenue Code of 1954:

Q–1: If an employer includes the value of a noncash fringe benefit in an employee's income, may the employer deduct both this amount (as compensation for services) and the costs incurred by the employer in providing the benefit to the employee?

A–1: No. For example, assume that an employer makes an automobile available to an employee solely for the employee's personal use during a calendar year. In addition, assume that the special rule provided in § 1.61–2T is used and that the Annual Lease Value (as defined in § 1.61–2T) is $2,100, which is the same amount that the employer paid to lease the automobile for the calendar year. The employer would only be entitled to deduct $2,100 with respect to such automobile. The employer would not be able to deduct both the cost of leasing the automobile for the calendar year and the Annual Lease Value.

If the employer had purchased, rather than leased the same automobile, and the depreciation with respect to such automobile was $1,500, the employer would only be entitled to deduct $1,500 with respect to such automobile. The employer would not be able to deduct both the depreciation and the Annual Lease Value.

PART 31—[AMENDED]

Par. 4. The following new section is added after § 31.3121(a)–1 and reads as follows:

§ 31.312(a)–1T Question and answer relating to the definition of wages in section 3121(a) (Temporary).

The following question and answer relates to the definition of wages in section 3121(a) of the Internal Revenue Code of 1954, as amended by section 531(d)(1)(A) of the Tax Reform Act of 1984 (98 Stat. 885):

Q–1: Are fringe benefits included in the definition of "wages" under section 3121(a)?

A–1: Yes, unless specifically excluded from the definition of "wages" pursuant to section 3121(a) (1) through (20). For example, a fringe benefit provided to or on behalf of an employee is excluded from the definition of "wages" if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132.

Par. 5. The following new section is added after § 31.3231(e)–1 and reads as follows:

§ 31.3231(e)–2T Question and answer relating to the definition of compensation in section 3231(e) (Temporary).

The following question and answer relates to the definition of "compensation" in section 3231(e) of the Internal Revenue Code of 1954, as amended by section 531(d)(2) of the Tax Reform Act of 1984 (98 Stat. 885):

Q–1: Does the term "compensation" include any benefit provided to or on behalf of an employee?

A–1: Yes, if the employment agreement provides, either expressly or impliedly, for the inclusion of the benefit as part of the employee's remuneration. However, even if the agreement either expressly or impliedly so provides, such benefit is not "compensation" if, at the time such benefit is provided, it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132.

Par. 6. The following new section is added after § 31.3306(b)–1 and reads as follows:

§ 31.3306(b)–1T Question and answer relating to the definition of wages in section 3306(b) (Temporary).

The following question and answer relates to the definition of wages in section 3306(b) of the Internal Revenue Code of 1954, as amended by section 531(d)(3) of the Tax Reform Act of 1984 (98 Stat. 885):

Q–1: Are fringe benefits included in the definition of wages under section 3306(b)?

A–1: Yes, unless specifically excluded from the definition of "wages" pursuant to section 3306(b) (1) through (16). For

example, a fringe benefit provided to or on behalf of an employee is excluded from the definition of "wages" if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132.

Par. 7. The following new section is added after § 31.3401(a)–1 and reads as follows:

§ 31.3401(a)–1T Question and answer relating to the definition of wages in section 3401(a) (Temporary).

The following question and answer relates to the definition of wages in section 3401(a) of the Internal Revenue Code of 1954, as amended by section 531(d)(4) of the Tax Reform Act of 1984 (98 Stat. 886):

Q–1: Are fringe benefits included in the definition of "wages" under section 3401(a)?

A–1: Yes, unless specifically excluded from the definition of "wages" pursuant to section 3401(a) (1) through (20). For example, a fringe benefit provided to or on behalf of an employee is excluded from the definition of "wages" if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 117 or 132.

Par. 8. The following new section is added after § 31.3404–1 and reads as follows:

§ 31.3501(a)–1T Question and answer relating to the time employers must collect and pay the taxes on noncash fringe benefits.

The following questions and answers relate to the time employers must collect and pay the taxes imposed by subtitle C on noncash fringe benefits:

Q–1: If a noncash fringe benefit constitutes "wages" under section 3121(a), 3306(b), or 3401(a), or constitutes "compensation" under section 3231(e), when must an employer collect and pay the taxes imposed by subtitle C?

A–1: For purposes of an employer's liability to collect and pay the taxes imposed by subtitle C, an employer may deem such fringe benefit to be paid at any time on or after the date on which it is provided, as long as such date is on or before the last day of the calendar quarter in which such benefit is provided. An employer may consider the benefit to be provided in two or more parts for purposes of the preceding sentence. For example, if a fringe benefit with a fair market value of $1,000 is provided on January 1, 1985, the employer could deem $500 paid on February 28, 1985 and $500 paid on March 31, 1985.

With respect to noncash fringe benefits provided during the first calendar quarter of 1985, a special rule applies. Such benefits may be deemed paid at any time on or after the date on which they are provided as long as the date they are deemed paid is on or before the last day of the second calendar quarter of 1985.

In addition, for purposes of § 31.6302(c)–1(a)(1)(i), the term "tax" does not include the employer tax under section 3111 with respect to noncash fringe benefits which are deemed by the employer to be paid on the last day of any calendar quarter. For purposes of the first sentence of § 31.6302(c)–2(a)(1), the phrase "employer tax imposed after December 31, 1983, under section 3221 (a) and (b)" will not include any such employer tax with respect to noncash fringe benefits which are deemed by the employer to be paid on the last day of the quarter; provided that for purposes of deposits required under § 31.6302(c)–1(a)(1)(v), such first sentence applies to such noncash fringe benefits.

Notwithstanding anything in this section to the contrary, if an employer in fact withholds, the amount withheld is subject to the general deposit rules.

The manner in which and the time at which the employer withholds amounts from the wages of an employee to pay the taxes imposed under section 3101, 3201, and/or 3402 will generally be left to be determined by the employer and the employee. Any delay in withholding, however, does not affect the employer's obligation upon the filing of an employment tax return, to pay amounts which would be due under this subtitle if the employer had withheld, with respect to noncash fringe benefits, the amount which would have been required to be withheld if such noncash fringe benefits had been paid in cash on the date the benefits were deemed paid. However, if such amounts are not withheld from the wages of an employee within a reasonable period after payment of the taxes by the employer, payment by the employer may be deemed additional compensation of the employee.

Q–2: Are any fringe benefits excepted from the rules contained in Q/A–1 of this section?

A–2: Yes. The rules contained in Q/A–1 of this section do not apply to the transfer of personal property (both tangible and intangible) of a kind held for investment or to the transfer of real property. Accordingly, an employer is liable for the collection and payment of taxes imposed by this subtitle when such property is transferred. For example, stock transferred in connection with the performance of services is paid, for purposes of this subtitle C, on the date the stock is transferred, i.e., on the date the stock vests pursuant to section 83 (absent a section 83(b) election).

Q–3: What is an example of the application of the rules contained in Q/A–1 of this section with respect to obligations under Chapters 21 and 24 of subtitle C?

A–3: All of employer A's employees received $100 in cash as wages each week from A. In addition, during a calendar quarter, each such employee receives noncash fringe benefits, the fair market value of which is $500. A deems all such noncash fringe beneftis to be paid on the last day of the quarter. As of the end of the quarter, no amount has been withheld from the employee's wages with respect to such noncash fringe benefits, and A has "undeposited taxes" (within the meaning of § 31.6302(c)–1(a)(1)(i)) of more than $3,000 attributable to amounts actually withheld under section 3102 or section 3402 or due under section 3111 with respect to cash wages of A's employees. The amount which A must deposit within 3 banking days after the end of the quarter will be determined without regard to the noncash fringe benefits deemed paid on the last day of the quarter.

During the month following the quarter, A withholds from its employees with respect to the noncash fringe benefits deemed paid on the last day of the quarter. As A withholds amounts, such amounts become "taxes" subject to § 31.6302(c)–1(a)(1)(i). If, as of the date of filing of the return for the period which includes the last day of the quarter, A has not deposited all amounts with respect to the quarter which are due under section 3111 or which would have been due had A withheld, under sections 3102 and 3402, with respect to noncash fringe benefits, the amount which would have been required to be withheld had such benefits been paid in cash, A shall pay the balance with its return. A must make such payment regardless of whether, at the time the return is filed, he has actually withheld all amounts which he would have been required to withhold had such benefits been paid in cash.

Q–4: If an employee is provided with a noncash fringe benefit and separates from service before the benefit is deemed paid by the employer, is the employer liable for the taxes imposed by subtitle C?

A–4: Yes. The employer's liability is unaffected by his ability to collect the tax from the former employer.

Q–5: If an entity other than the employer provides a noncash fringe

benefit to an employee, is that entity considered the employer of such employee with respect to such noncash fringe benefit for any purposes of subtitle C?

A–5: The provision of noncash fringe benefits by an entity to an employee of another employer does not make such entity the employer of such employee with respect to such noncash fringe benefit for any purpose of subtitle C, so long as such noncash fringe benefits are incidental to the provision of wages by the employer to such employee. For example, if two unrelated airlines, A and B, enter into a reciprocal agreement where by the parents of employees of both airlines are entitled to free flights on both airlines, the fact that A is providing a noncash fringe benefit to the employees of B generally will not make A the employer of such employees for purposes of subtitle C.

Q–6: Do special rules apply to the provision of taxable noncash fringe benefits by a nonemployer under a reciprocal agreement with the employee's employer?

A–6: If the provision of taxable noncash fringe benefits meets the requirements of Q/A–5 of this section, the nonemployer provider of the benefits is not required to withhold. The employer must take the steps necessary to obtain the relevant information from the provider of the benefits in order to enable the employer to satisfy, in a timely manner, its obligations under subtitle C to collect and pay taxes with respect to the noncash fringe benefits provided by the nonemployer.

Q–7: For purposes of subtitle C, how is the fair market value of an employer-provided automobile during any time period to be determined?

A–7: The fair market value of an employer-provided automobile must be determined under the rules provided in § 1.61–2T and § 1.132–1T. For example, assume that an employee adopts the special rule provided in § 1.61–2T and that the Annual Lease Value, as defined in § 1.61–2T, of an automobile is $2,100. The automobile is provided to employee A on January 1, 1985. As of March 31, A had driven the automobile 1,000 personal miles and 3,000 miles in the course of his employer's business. For the quarter, A would have had wages of $131.25 attributable to his personal use of the automobile computed by subtracting a $393.75 working condition fringe from $525 ($2,100 divided by 4). See section 132(d) and § 1.132–1T. During the second quarter of 1985, A drives the automobile only 1,000 miles, all of which are personal. In order to calculate the value of the wages provided to A in the second quarter in the form of the availability of the employer-provided automobile, first A's employer calculates the Annual Lease Value attributable to the first six months of 1985 which is $1,050 ($2,100 divided by 2). Second, A's employer calculates the working condition fringe exclusion which is $630 ($1,050 multiplied by a fraction the numerator of which is A's business mileage (3,000 miles) and the denominator of which is A's total mileage (5,000 miles)). The calculations result in a total inclusion of $420 ($1,050—$630). From the total inclusion of $420, the wages provided in the first quarter, $131.25, are subtracted, leaving $288.75 as the wages includible in the second quarter attributable to the availability to A of the employer-provided automobile.

Q–8: May an employer treat the Annual Lease Value or Daily Lease Value (as defined in § 1.61–2T), or the fair market value if the special rule of § 1.61–2T is not used, of an employer-provided automobile made available to an employee as fully includible in the employee's gross income without regard to whether the employee has used the automobile in the employer's business?

A–8: No. Before including any amount in an employee's gross income, the employer must request that the employee furnish the employer with either records or a statement which shows, with respect to each employer-provided automobile, the number of miles driven by the employee in the employer's business and the number of total miles driven by such employee. (For purposes of this Q/A–8, if an automobile is available to any person and such availability would be taxed to an employee, miles driven by such person will be considered miles driven by the employee.) Such records or statement requested must relate to the period or periods with respect to which the employer is determining the amount that must be included in the employee's gross income. Unless the employer knows or has reason to know that such records or statement is not accurate, the employer must report the employee's income after taking into account the business and total use shown by such records or statement. If the employee fails to respond within a reasonable period of time, or if the employee produces records or a statement which the employer knows or has reason to know is not accurate, the employer may include in the employee's gross income an amount calculated without regard to a working condition fringe exclusion based on business mileage with respect to the employer-provided automobile.

In addition, the employer must, before reporting any amount as gross income with respect to an employer-provided automobile, take into account other working condition fringe exclusions, such as the security exclusion discussed in § 1.132–1T. If proper calculation of an exclusion requires information from the employee and the employee either does not respond within a reasonable period of time to a request for such information or produces information which the employer knows or has reason to know is not accurate, the employer may disregard such exclusion in reporting such employee's gross income.

Q–9: If an employee purchases any property or service from an employer at a discount and the discount is not excludable under section 132 and any applicable regulations thereunder, when is the noncash fringe benefit provided?

A–9: Such property or service is provided at the time that ownership is transferred, in the case of property, or the time service is rendered, in the case of services. This will be true regardless of when the employee pays for such property or service or the date payment is due or the rate of interest charged prior to payment. The time at which ownership of the property is transferred must be determined under general tax principles.

Q–10: What rules apply with respect to the treatment of the payment of any noncash fringe benefit as the payment of supplemental wages under section 3402?

A–10: An employer may treat the payment of any noncash fringe benefit as the payment of supplemental wages. Thus, if noncash fringe benefits are provided and tax has been withheld from the employee's regular wages, the employer may determine the tax to be withheld with respect to such noncash fringe benefits by using a flat percentage rate of 20 percent, without allowance for exemptions and without reference to any regular payment of wages. For example, assume that during a calendar quarter A receives from his employer a taxable noncash fringe benefit with a fair market value of $1,000. If the requirements specified above are satisfied, A's employer may determine the tax to be withheld with respect to such benefit by using a flat percentage rate of 20 percent. The employer may also determine the tax to be withheld with respect to such benefit by use of the method described in § 31.3402 (g)–1(a)(2).

PART 54—[AMENDED]

Par. 9. The following new section is added after § 54.4975–15 and reads as follows:

§ 54.4977-1T Questions and answers relating to the election concerning lines of business in existence on January 1, 1984 (Temporary).

The following questions and answers relate to the election by employers under section 4977 of the Internal Revenue Code of 1954, as added by section 531(e)(1) of the Tax Reform Act of 1984 (98 Stat. 886), to treat all employees of any line of business in existence on January 1, 1984, as employees of one of those lines of business for purposes of section 132(a) (1) and (2):

Q-1: What does section 4977 provide with respect to the exclusion from gross income of certain fringe benefits?

A-1: In general, section 4977 provides an elective grandfather rule that allows an employer under certain circumstances to treat employees of all lines of business which were in existence on January 1, 1984, as employees of one of those lines of business for purposes of section 132(a) (1) and (2), but not for purposes of section 132(g)(2).

Q-2: Under what circumstances does the elective grandfather rule of section 4977 apply?

A-2: If—

(a) an election under section 4977 is in effect with respect to an employer for any calendar year, and

(b) on and after January 1, 1984, at least 85 percent of the employees of the employer in all of its lines of business which existed on January 1, 1984, were entitled to employee discounts or services provided by the employer in one line of business,

then all employees of any line of business of the employer which was in existence on January 1, 1984, are treated, for purposes of section 132(a) (1) and (2) (but not for purposes of section 132(g)(2)) as employees of the one line of business referred to in (b) of this Q/A-2.

Q-3: How does an employer make the election provided for in section 4977?

A-3: An employer must file a statement with the director of the service center with which the employer's tax returns are filed. The statement must indicate that the employer is electing to apply the provisions of section 4977 to one or more of the employer's lines of business and must contain the following information:

(a) The employer's name, address, and taxpayer identification number;

(b) A description of all of the employer's lines of business in existence on January 1, 1984; and

(c) For each lines of business which is to have as an employee for purposes of section 132(a) (1) and (2) an individual but for the election under section 4977 would not be treated as an employee for purposes of section 132(a) (1) and (2)—

(1) A description of the no-additional-cost service or qualified employee discount (including, with respect to discounts, the percentage discount) to be offered to employees pursuant to section 4977 in such line of business, and

(2) With respect to employees in all of the employer's lines of business in existence on January 1, 1984, the number of such employees and the number entitled to the described fringe benefit. Such numbers may be determined as of a date which does not precede the date the election is filed by more than 30 days.

Q-4: In order to make a timely section 4977 election, when must an employer file the election statement?

A-4: Except as otherwise provided in the second senfence of this answer, the employer must file the election statement before the end of the calendar year preceding the year for which the election is to apply. For calendar year 1985, however, the employer has until March 31, 1985, to file the election statement. However, the Commissioner may, in his discretion, extend the March 31, 1985 deadline to a later date.

Q-5: Does section 4977 apply to all calendar years following the calendar year in which the election is made?

A-5: Yes, unless the employer revokes the election.

Q-6: When is a revocation effective?

A-6: A revocation is effective with respect to the calendar year following the calendar year in which it is filed.

Q-7: If an employer does not make a timely section 4977 election with respect to 1985, will the employer be entitled to make an election with respect to any subsequent year?

A-7: No.

Q-8: If an employer revokes a section 4977 election, is the employer entitled to elect the application of section 4977 for subsequent years?

A-8: No.

The regulations are issued under the authority contained in sections 132 and 7805 of the Internal Revenue Code of 1954 (Title 26 of the United States Code).

M. Eddie Heironimus,

Acting Commissioner of Internal Revenue.

Approved: December 31, 1984.

Ronald A. Pearlman,

Acting Assistant Secretary of the Treasury.

[FR Doc. 85-292 Filed 1-2-85; 9:44 am]

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Bureau of Alcohol, Tobacco and Firearms

27 CFR Part 4

[T.D. ATF-194; Ref: Notice No. 547]

Extension of Mandatory Compliance Date for Registry Number of American Bottler, and Geographical Brand Names

AGENCY: Bureau of Alcohol, Tobacco and Firearms (ATF), Department of the Treasury.

ACTION: Treasury decision, final rule.

SUMMARY: This final rule amends the mandatory compliance date of January 1, 1985, to January 1, 1987, with regard to two labeling requirements for wine found in 27 CFR Part 4. The affected regulations concern the American bottler's registry number requirement, and the "brand" requirement for brand names having geographical significance. This action is being taken since both regulations are involved in rulemaking and may subsequently be amended.

These regulations were first promulgated under Treasury Decision ATF-53, published in the **Federal Register** on August 23, 1978 (43 FR 37672, 54624). However, certain of those regulations were challenged in court. *Wawszkiewicz* v. *Department of the Treasury*, 480 F.Supp. 739 (D.D.C 1979), *aff'd in part, rev'd in part* and *remanded with directions*, 670 F.2d 296 (D.C. Cir. 1981).

This final rule only addresses the extension of the mandatory compliance date. The final rule concerning the registry number of the bottler, also discussed in Notice No. 547, will be published at a later date, after the comment period closes (January 22, 1985), and the comments have been analyzed.

EFFECTIVE DATE: February 6, 1985.

FOR FURTHER INFORMATION CONTACT: James P. Ficaretta or Edward A. Reisman, FAA, Wine and Beer Branch, Bureau of Alcohol, Tobacco and Firearms, 1200 Pennsylvania Avenue, NW, Washington, DC 20226, 202-566-7626.

SUPPLEMENTARY INFORMATION:

Notice No. 547

On October 23, 1984, AFT published Notice No. 547 (49 FR 42577), proposing to take regulatory action on the provision in the wine regulations which requires, in part, that the registry number of the bottler be shown in direct conjunction with the name and address of the bottler (27 CFR 4.35(d)). The