

permanently and involuntarily displaced as a result of the use of assistance received under this part to acquire or substantially rehabilitate property where such displacement is not subject to the Uniform Act. The grantee shall develop, adopt, and provide to persons to be displaced a written statement of the standards it will use for providing relocation assistance, consistent with the following minimum requirements:

(1) A residential tenant who moves will be considered displaced from his or her dwelling if:

(i) The tenant has not been provided a decent, safe, and sanitary dwelling unit on the property following the completion of the assisted activity at a monthly cost for rent and utilities that does not exceed the greater of:

(A) The tenant's cost for rent and utilities at the time of preliminary funding approval for the UDAG assistance; or

(B) 30 percent of the tenant household's gross income; or

(ii) Temporary relocation is required and the tenant is not reimbursed for all reasonable out-of-pocket expenses incurred in connection with the temporary relocation.

(2) Eligibility criteria for relocation assistance must cover:

(i) Any tenant legally occupying the property at the time the grantee enters into a contract to provide assistance for the acquisition or rehabilitation; and

(ii) Any tenant who legally moves into the property between such event and the actual acquisition or rehabilitation without receiving prior written notice of his or her possible displacement as a result of the planned acquisition or rehabilitation.

(3) Any residential or nonresidential tenant who is determined under grantee standards to be displaced as a direct result of rehabilitation or acquisition assisted under this part (not subject to the Uniform Act) must be provided relocation assistance, including at a minimum:

(i) Reasonable moving expenses;

(ii) Advisory services needed to help in relocating; and

(iii) For a displaced residential tenant:

(A) Referral to at least one suitable, decent, safe and sanitary replacement dwelling unit. The grantee shall advise tenants of their rights under the Federal Fair Housing Law (Title VIII) and of replacement housing opportunities in such a manner that, whenever feasible, they will have a choice between relocating within their neighborhood and other neighborhoods consistent with the grantee's responsibility to

affirmatively further fair housing; and

(B) Either (1) Payment at least equal to 24 times the increase, if any, between the monthly cost of rent and utilities at the dwelling unit from which the tenant is displaced and the cost of rent and utilities at a suitable, decent, safe and sanitary replacement dwelling unit, or (2) The provision of a certificate or housing voucher for rental assistance payments under the Section 8 Housing Assistance Payments Program, if the tenant is an eligible lower income person.

(4) For purposes of this paragraph (c), the term "tenant" includes any family, individual, business, nonprofit organization or farm that is a renter. It also includes any owner-occupant displaced as a direct result of non-Uniform Act acquisition by an agency with the power of eminent domain and any displaced owner-occupant of a manufactured (mobile) home who rents the site.

(d) *Appeals.* If a person disagrees with the applicant's determination concerning the person's eligibility for, or the amount of relocation payment under this section, the person may file a written appeal of that determination with the applicant. The appeal procedures to be followed are described in 24 CFR 42.10.

(Approved by the Office of Management and Budget under control number 2506-0084)

5. Section 570.458(c)(14)(ix)(I) is revised as follows:

§ 570.458 Full applications.

(c) * * *

(14) * * *

(ix) * * *

(I) The acquisition and relocation requirements of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (Uniform Act), HUD implementing regulations in Part 42 of this title, and the relocation requirements in § 570.457(c) governing displacement subject to section 104(j) of the Housing and Community Development Act of 1974.

Dated: January 23, 1987.

Jack R. Stockvis,

General Deputy, Assistant Secretary for Community Planning and Development.

[FR Doc. 87-2302 Filed 2-4-87; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 18, and 602

[T.D. 8123]

Income Taxes; Limitation on Certain Adoptions, Changes, and Retentions of Annual Accounting Period

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations and amendments to final rules.

SUMMARY: This document provides temporary regulations relating to certain changes, adoptions, and retentions of annual accounting period. The regulations are needed to ensure that taxpayers do not attempt to change to, adopt, or retain a taxable year that is a fiscal year (including a 52-53-week taxable year) in order to circumvent the effective date provisions of the Tax Reform Act of 1986. The regulations affect certain persons who wish to change to, adopt, or retain a taxable year that is a fiscal year during the period covered by the temporary regulations and provide these persons with the guidance needed to comply with the law.

EFFECTIVE DATES: For §§ 1.441-2(f), 1.441-3T, 1.442-1(f) and 1.442-2T, September 29, 1986; for §§ 1.442-3T, 1.706-1 (b) (7) and 18.1378-1 (e), November 5, 1986; for § 602.101 (c), January 22, 1987.

FOR FURTHER INFORMATION CONTACT:

Arthur E. Davis III of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224 (Attn: CC:LR:T). Telephone 202-566-3238 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations (26 CFR Part 1) and the Temporary Income Tax Regulations under the Subchapter S Revision Act of 1982 (26 CFR Part 18) to provide temporary rules relating to certain changes, adoptions, and retentions of annual accounting period under sections 441, 442, 706, and 1378 of the Internal Revenue Code of 1954. In general, the temporary regulations limit the ability of certain taxpayers to change to, adopt, or retain a taxable year that is a fiscal year (including a 52-53-week taxable year ending with reference to the month of December) during the period to which the temporary regulations apply. The Internal Revenue Service announced in

Announcement 86-101, 1986-41 I.R.B. 14, and Announcement 86-113, 1986-47 I.R.B. 46, that temporary regulations providing these limitations would be issued.

Explanation of Provisions Changes of Annual Accounting Period

The temporary regulations relating to changes of annual accounting period generally suspend the provisions of §§ 1.441-2 (c), 1.442-1 (c), and 1.706-1 (b) of 26 CFR Part 1, § 18.1378-1 of 26 CFR Part 18, Rev. Proc. 72-51, 1972-2 C.B. 832, and any revenue procedure issued before September 18, 1986, that otherwise would permit a taxpayer to change its taxable year (including a change to a 52-53-week taxable year) either under a procedure that does not require the prior approval of the Commissioner or under expedited procedures for securing that approval. In addition, the temporary regulations provide that the Commissioner generally will not consider a request for approval of a change of annual accounting period unless the taxpayer has had a substantial acquisition or divestiture determined in accordance with the temporary regulations, or the taxpayer meets certain other conditions. The temporary regulations allow certain taxpayers to change their annual accounting period without the prior approval of the Commissioner if the taxpayer has a substantial business purpose for the change as evidenced by the satisfaction of a mechanical test. Certain taxpayers, however, must obtain prior approval to a change even if the mechanical test is satisfied.

The mechanical test generally is the same as the "25 percent test" set forth in section 4.04 of Rev. Proc. 83-25, 1983-1 C.B. 689. Under the mechanical test, the gross receipts from sales or services for the last two months of each of three 12-month periods that end with the last month of the requested taxable year must equal or exceed 25 percent of the gross receipts from sales or services for that 12-month period. If more than one taxable year meets this mechanical test, a substantial business purpose is evidenced only for the year for which the arithmetical average of the percentages obtained under the mechanical test for the three applicable 12-month periods is highest.

For purposes of the mechanical test, the three 12-month periods are the most recent 12-month period (determined at the time the statement or application required to effect or request the change is filed) ending with the last month of the requested taxable year and the two preceding 12-month periods that end with the corresponding month. A

taxpayer must test the three 12-month periods that end with months other than the last month of the requested taxable year, however, in order to determine if more than one taxable year meets the mechanical test.

A taxpayer that has not been in existence for the three 12-month periods described above may evidence a substantial business purpose under the mechanical test by taking into account the gross receipts from sales and services of a predecessor organization. Gross receipts of a predecessor organization shall not be taken into account, however, unless the predecessor organization was actively engaged in a trade or business at all times during the portion of the three applicable 12-month periods prior to the inception of the taxpayer. Thus, a taxpayer in existence for only the most recent applicable 12-month period may use the gross receipts from the two preceding 12-month periods of a predecessor organization.

Although a mechanical test is used in these temporary regulations to determine whether a taxpayer has a business purpose for a particular taxable year, taxpayers should not infer that a mechanical test always will be used to determine business purpose in future years. The Service is studying the mechanical test to determine when its use is appropriate.

The temporary regulations do not apply to certain changes of annual accounting period, including a change to a calendar year. Thus, for example, a corporation seeking S status will be permitted to change its taxable year automatically to a calendar year under § 18.1378-1 (b) (1) (for the first year for which the S election is effective) if all of its principal shareholders are calendar year taxpayers and if the corporation satisfies all of the applicable requirements under that section. Similarly, a corporation (including a regulated investment company as defined in section 851) will be permitted to change automatically to a calendar year under § 1.442-1 (c) provided that the corporation satisfies all of the applicable requirements under that section.

The temporary regulations generally apply to any change in annual accounting period if the income tax return for the short period involved in the change is filed after September 29, 1986, and the short period involved in the change ends before January 5, 1987. The temporary regulations do not apply, however, if the application required to effect or request the change (*i.e.*, Form 1128 or Form 2553) was timely filed

before September 30, 1986. In the case of a change that is effected by filing an income tax return for the short period involved in the change, the temporary regulations do not apply if an application for extension of time for filing that return was filed before September 30, 1986, the application clearly stated the year to which the taxpayer intended to change, and the income tax return for the short period subsequently is timely filed (determined with regard to extensions).

The temporary regulations include an anti-abuse rule that is applicable to any adoption by a taxpayer of a taxable year that has the effect of circumventing the limitations prescribed under the temporary regulations on changes of annual accounting period. Thus, for example, a corporation will not be able to circumvent the provisions of the temporary regulations by creating a new corporation that adopts the desired fiscal year and by transferring some or all of the net assets of the existing corporation to the new corporation.

52-53-Week Taxable Year

The temporary regulations provide special rules applicable to certain entities and investors in those entities that wish to adopt, retain, or change to or from a 52-53-week taxable year. Under those rules, a partnership, partner, S corporation (or corporation seeking S status), S corporation shareholder, personal service corporation, or employee-owner of a personal service corporation must agree to certain conditions in order to change to or from a 52-53-week taxable year or to adopt or retain such a year. The conditions relate to the taxable year in which a partner, S corporation shareholder, or employee owner must take into account items passed through or paid by the partnership, S corporation, or personal service corporation.

The temporary regulations also include a rule to prevent the evasion or avoidance of tax through the adoption of or change to or from a 52-53-week taxable year by any taxpayer, including a corporation that is not seeking S status. The temporary regulations provide that a taxpayer may not adopt or change to or from a 52-53-week taxable year if the principal purpose for such action is the evasion or avoidance of Federal income tax.

The temporary regulations relating to adoptions of, retentions of, or changes to or from a 52-53-week taxable year generally apply if the first taxable year for which the election to use or retain the 52-53-week year is made (or, if

applicable, the short period involved in the change) ends before January 5, 1987, and the income tax return for that year (or period) is filed after September 29, 1986. The temporary regulations do not apply, however, if the application required to effect or request the adoption, retention, or change (i.e., Form 1128 or Form 2553) was timely filed before September 30, 1986. In the case of an adoption or change that is effected by filing an income tax return for the first taxable year for which the election is made, the temporary regulations do not apply if an application for extension of time for filing that return was filed before September 30, 1986, the application clearly stated the taxpayer's intent to adopt or change to a 52-53-week taxable year, and the income tax return for that year is timely filed (determined with regard to extensions).

Adoptions and Retentions of a Taxable Year

The temporary regulations generally provide that a partnership or corporation seeking S status may not adopt or retain a taxable year that results in a deferral of income to its partners or shareholders unless the taxpayer establishes a substantial business purpose for the adoption or retention. Thus, the temporary regulations suspend the applicable provisions of Rev. Proc. 72-51, 1972-2 C.B. 832, and § 4.03 of Rev. Proc. 83-25, 1983-1 C.B. 689, for the period to which the temporary regulations apply. The temporary regulations also contain special rules (including a mechanical test) for determining whether a taxpayer has established a substantial business purpose for the adoption or retention of a taxable year that results in a deferral of income to its partners or shareholders.

The temporary regulations relating to adoptions and retentions of a taxable year generally apply if the first taxable year of the partnership or the first taxable year for which the S election is effective begins before January 1, 1987, unless the application necessary to effect or request the adoption or retention was timely filed before November 6, 1986. The regulations do not apply, however, to an adoption by a partnership of a taxable year that begins before January 1, 1986. The regulations also do not apply to certain adoptions or retentions, such as an adoption or retention of a calendar year.

Executive Order 12291, Regulatory Flexibility Act, and Paperwork Reduction Act

The Commissioner of Internal Revenue has determined that this

temporary rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis therefore is not required. 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).

The collection of information requirements contained in this regulation 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 under control number 1545-0134.

Drafting Information

The principal author of these regulations is Alice M. Bennett 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 1.441-1—1.483-2

Income taxes, Accounting, Deferred compensation plans.

26 CFR Part 18

Sale of residence, Income taxes.

26 CFR Part 602

Reporting and record keeping requirements.

Amendments to the Regulations

For the reasons set out in the preamble, Subchapter A, Parts 1 and 18 and Subchapter H, Part 602 of title 26, Chapter I of the Code of Federal Regulations are amended as set forth below:

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

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.441-3T also issued under 26 U.S.C. 441. Sections 1.442-2T and 1.442-3T also issued under 26 U.S.C. 422, 706, and 1378.

Par. 2. Section 1.441-2 is amended by adding the following new paragraph (f):

§ 1.441-2 Election of year consisting of 52-53 weeks.

* * *

(f) *Cross-reference to § 1.441-3T.* For special rules relating to certain adoptions of or changes to or from a 52-53-week taxable year ending in 1986 or 1987, see § 1.441-3T.

Par. 3. Section 1.441-3T is added in the appropriate place.

§ 1.441-3T Special rules for certain adoptions of, retentions of, or changes to or from a 52-53-week taxable year (Temporary).

(a) *Applicability.* This section applies to any partnership, partner, S corporation, S corporation shareholder, personal service corporation, or employee-owner that wishes to adopt or change to or from a 52-53-week taxable year. This section also applies to a corporation seeking S status that wishes to adopt, retain, or change to or from a 52-53-week taxable year. This section applies in the case of a change to or from a 52-53-week taxable year whether or not the taxpayer also wishes to change the month with reference to which its taxable year ends. Paragraph (c) (2) of this section applies to any taxpayer (including, for example, a corporation that is not seeking S status) that wishes to adopt or change to or from a 52-53-week taxable year.

(b) *Definitions.*—(1) *Personal service corporation.* For purposes of this section only, the term "personal service corporation" means any corporation (other than an S corporation) if—

(i) The principal activity of that corporation is the performance of personal services, and

(ii) Such services are substantially performed by employee-owners.

A corporation shall not be treated as a personal service corporation, however, unless more than 10 percent of the fair market value of the outstanding stock of the corporation is held by employee-owners.

(2) *Employee-owner.* For purposes of this section, the term "employee-owner" means an employee who owns, on any day of the corporation's taxable year, any outstanding stock of the personal service corporation. Section 318 will apply to determine stock ownership for purposes of this paragraph (b), except that "any" is to be substituted for "50 percent or more in value" in section 318(a)(2)(C).

(3) *Performance of a substantial portion of services.* For purposes of paragraph (b)(1) of this section, personal services are substantially performed by employee-owners if the total time spent by employee-owners in performing those services is 10 percent or more of the total time spent by all employees (including employee-owners) in

performing those services. In determining time spent in performing personal services of a corporation, time spent on matters that do not relate directly and intrinsically to the performance of services for or on behalf of clients or customers of the corporation shall not be taken into account. Thus, for example, in the case of a corporation performing accounting services, time spent in performing secretarial services, managerial work of a purely administrative nature, or janitorial services shall not be taken into account in determining either the time spent by employee-owners in performing accounting services or the total time spent by all employees in performing accounting services. Managerial time shall be taken into account, however, to the extent that it consists of the supervision of accounting services performed by employees for or on behalf of clients or customers of the corporation.

(c) *General rule*—(1) *Satisfaction of applicable conditions.* A taxpayer to which this section applies may not adopt, retain, or change to or from a 52-53-week taxable year under § 1.441-2(c) (1) or (2), § 1.442-1, or 26 CFR 18.1378-1 unless each of the applicable conditions set forth in paragraph (d) of this section is satisfied with respect to the taxpayer seeking the adoption, retention, or change. For additional requirements applicable to certain taxpayers that wish to adopt, retain, or change to or from a 52-53-week taxable year, see §§ 1.442-2T and 1.442-3T.

(2) *Evasion or avoidance of tax*—(i) *General rule.* A taxpayer may not adopt or change to or from a 52-53-week taxable year if the principal purpose for such action is the evasion or avoidance of Federal income tax.

(ii) *Example.* The provisions of this paragraph (c)(2) may be illustrated by the following example.

Example. Assume that X, a calendar year corporation, wishes to elect, for taxable years beginning after December 31, 1985, a 52-53-week taxable year that ends on the Tuesday nearest to December 31. Assume that such election allows the corporation to sell a substantial portion of its assets on Wednesday, December 31, 1986, and to report the income from such sale in the taxable year beginning on December 31, 1986, and ending on December 29, 1987. By electing the 52-53-week taxable year, the corporation obtains the advantages of the lower Federal income tax rates applicable for the period beginning December 31, 1986. Moreover, the sale of the assets on December 31 allows the buyer of the assets, a calendar year taxpayer, to obtain certain Federal income tax advantages that are not available with respect to purchases of assets in 1987 and later years. Given the above facts, it is presumed that the

principal purpose for such action is the evasion or avoidance of Federal income tax. Thus, X may not adopt a 52-53-week taxable year.

(d) *Conditions applicable to certain taxpayers*—(1) *Conditions.* (i) If the taxpayer seeking the adoption or change is a partnership, all of the partners (determined at the close of the first taxable year of the partnership for which the election to use the 52-53-week taxable year is made or, if applicable, the short period involved in the change) must agree to treat the current and all subsequent 52-53-week years of the partnership (and of any partner) as ending on the last day of the calendar month that ends nearest to the last day of the 52-53-week year for purposes of determining the taxable year in which the inclusions required by sections 702 and 707(c) are taken into account.

(ii) If the taxpayer seeking the adoption or change is a partner, the partner must agree to treat the current and all subsequent 52-53-week years of the partner (and the 52-53-week years of any partnership in which such taxpayer is a partner) as ending on the last day of the calendar month that ends nearest to the last day of the 52-53-week year for purposes of determining the taxable year in which the inclusions required by sections 702 and 707(c) are taken into account.

(iii) If the taxpayer seeking the adoption, retention, or change is an S corporation or a corporation seeking S status, all of the shareholders (determined at the close of the first taxable year of the S corporation for which the election to use or retain the 52-53-week year is made or, if applicable, the short period involved in the change) must agree to treat the current and all subsequent 52-53-week taxable years of the corporation (and of any shareholder) as ending on the last day of the calendar month that ends nearest to the last day of the 52-53-week year for purposes of determining the taxable year in which the inclusions required by section 1366 are taken into account.

(iv) If the taxpayer seeking the adoption or change is an S corporation shareholder, the shareholder must agree to treat the current and all subsequent 52-53-week taxable years of the shareholder (and the 52-53-week years of any S corporation in which such taxpayer is a shareholder) as ending on the last day of the calendar month that ends nearest to the last day of the 52-53-week year for purposes of determining the taxable year in which the inclusions required by section 1366 are taken into account.

(v) If the taxpayer seeking the adoption or change is a personal service corporation, all of the employee-owners (determined at the close of the first taxable year of the corporation for which the election to use the 52-53-week taxable year is made or, if applicable, the short period involved in the change) must agree to treat the current and all subsequent taxable years of an employee-owner and the corporation that end with or with reference to the same calendar month as if both such taxable years ended on the last day of the taxable year of the corporation for purposes of determining the taxable year in which payments (whether or not in cash) that are deductible by the corporation are taken into account by the employee-owner.

(vi) If the taxpayer seeking the adoption or change is an employee-owner of a personal service corporation, the employee-owner must agree to treat the current and all subsequent taxable years of the employee-owner and the corporation that end with or with reference to the same calendar month as if both such taxable years ended on the last day of the taxable year of the corporation for purposes of determining the taxable year in which payments (whether or not in cash) that are deductible by the corporation are taken into account by the employee-owner.

(2) *Examples.* The provisions of paragraph (d)(1) of this section may be illustrated by the following examples.

Example (1). Assume that ABC, a calendar year partnership, wishes to elect, for taxable years beginning after December 31, 1985, a 52-53-week taxable year that ends on the Friday nearest to December 31. Assume that A, B, and C, who are individual calendar year taxpayers, are equal partners in ABC. Assume also that A, B, and C agree to treat each of the 52-53-week taxable years of ABC as ending on December 31 for purposes of determining the taxable year in which guaranteed payments and their distributive shares of income, gains, losses, deductions, and credits are taken into account. Assume that, for its taxable year ending January 2, 1987, ABC has net income of \$30,000, and that ABC has no other items of income, gain, loss, deduction, or credit for that taxable year. Under paragraph (d)(1)(i) of this section, A, B, and C each must include \$10,000 in income for their taxable years ending on December 31, 1986. Similarly, if ABC makes a guaranteed payment to A on January 2, 1987, A must include the payment in income for the taxable year ending December 31, 1986.

Example (2). Assume that X, a calendar year personal service corporation, wishes to elect, for taxable years beginning after December 31, 1985, a 52-53-week taxable year that ends on the Friday nearest to December 31. Assume that all of the employer-owners of X are individual calendar year taxpayers. Assume further that

all of the employee-owners agree to treat their taxable year as ending on the last day of X's taxable year for purposes of determining the year in which payments by X are taken into income. Assume that on January 2, 1987, X makes a payment of bonuses of \$10,000 to each employee-owner. Under paragraph (d)(1)(v) of this section, each employee-owner must include \$10,000 in income for the taxable year ending December 31, 1986.

(e) *Procedural requirements.* In the case of an adoption of or change to a 52-53-week taxable year under § 1.441-2(c) (1) or (2), a taxpayer to which any condition in paragraph (d) of this section applies must indicate on the statement required under § 1.441-2(c) (1) or (2), or on a separate statement that is attached to the income tax return for the year of adoption or change, that all of the applicable conditions are satisfied. If the due date for that return is before March 9, 1987, the statement required under § 1.441-2(c) (1) or (2) (or an amended statement) indicating that the applicable conditions are satisfied must be filed by the later of March 9, 1987 or the due date for the return (determined with regard to extensions). If § 1.442-2T or § 1.442-3T applies to an adoption of, retention of, or change to or from a 52-53-week taxable year, the procedures set forth in § 1.442-2T or § 1.442-3T (whichever is applicable) must be followed and the rules set forth in § 1.442-2T(f)(3) or § 1.442-3T(d) shall apply.

(f) *Effective date.*—(1) *In general.* This section shall apply to adoptions of, retentions of, or changes to or from a 52-53-week taxable year if—

(i) The income tax return for the first taxable year for which the election to use or retain the 52-53-week year is made (or, if applicable, the income tax return for the short period involved in the change) is filed after September 29, 1986, and

(ii) The first taxable year for which the election to use or retain the 52-53-week year is made (or the short period involved in the change) ends before January 5, 1987.

(2) *Exceptions.* This section shall not apply if the application required to effect or request the adoption, retention, or change was timely filed before September 30, 1986. In the case of an adoption or change that is effected by filing an income tax return for the first taxable year for which the election is made, this section shall not apply if an application for extension of time for filing that return was filed before September 30, 1986, the application clearly stated the taxpayer's intention to adopt or change to a 52-53-week taxable year, and the income tax return for that

taxable year is timely filed (determined with regard to extensions).

Par 4. Paragraph (f) of § 1.442-1 is amended by adding the following sentences at the end thereof:

§ 1.442-1 Change of annual accounting period.

* * * * *

(f) *Effective date.* * * * For special rules applicable to certain changes of annual accounting period that result in a short period ending in 1986 or 1987, see § 1.442-2T. For special rules applicable to certain adoptions and retentions of a taxable year ending in 1986 or 1987, see § 1.442-3T.

Par. 5. Section 1.442-2T is added at the appropriate place.

§ 1.442-2T Special limitations on certain changes of annual accounting period (Temporary).

(a) *Applicability.* This section applies to any taxpayer that wishes to change its annual accounting period, or that wishes to adopt an annual accounting period described in paragraph (h) of this section. This section shall not apply, however, to:

(1) Any taxpayer to which the provisions of § 1.1502-76 apply (other than a taxpayer to which the provisions of paragraph (h) of this section apply);

(2) Any taxpayer to which the provisions of § 1.442-1(e) apply;

(3) Any taxpayer that wishes to change its annual accounting period to a calendar year (including a change under 26 CFR 18.1378-1(b)) or to a 52-53-week taxable year that ends with reference to the month of December (see, however, § 1.441-3T);

(4) Any partnership that wishes to change its annual accounting period under § 1.706-1(b)(1) to the same taxable year as that of all of its principal partners or to which all of its principal partners are concurrently changing;

(5) Any corporation seeking S status that wishes to change its annual accounting period under section 4.02 of Rev. Proc. 83-25, 1983-1 C.B. 689, to the same taxable year as that of shareholders holding more than 50 percent of the shares of stock of the corporation or to which such shareholders are concurrently changing;

(6) Any corporation seeking S status that wishes to change its annual accounting period under section 4.04 of Rev. Proc. 83-25, 1983-1 C.B. 689;

(7) Any taxpayer that wishes to change to a 52-53-week taxable year that ends with reference to the same calendar month as that in which the former taxable year ended (see, however, § 1.441-3T); or

(8) Any organization exempt under section 501(a), and any plan meeting the requirements for qualification under section 401(a) and which is exempt under section 501 (a), except those organizations and plans required to file a Form 990-T for the short period involved in the change of annual accounting period.

(b) *General rule.* A taxpayer to which this section applies may not change its annual accounting period under the provisions of—

(1) Paragraph (c) of § 1.442-1,

(2) Paragraph (b) of § 1.706-1,

(3) 26 CFR 18.1378-1(b),

(4) Rev. Proc. 72-51, 1972-2 C.B. 832, or

(5) Any revenue procedure issued before September 18, 1986, that, without regard to this section, would permit a taxpayer to change its taxable year either under a procedure that does not require the prior approval of the Commissioner or under expedited procedures for obtaining that approval.

Examples of procedures suspended by paragraph (b)(5) of this section include Rev. Proc. 84-34, 1984-1 C.B. 508, and those portions of Rev. Proc. 83-25, 1983-1 C.B. 689, that apply to changes of annual accounting period. In addition, the Commission will not consider a request by a taxpayer to which this section applies for approval of a change of annual accounting period under § 1.442-1(b)(1) unless the requirements of paragraph (e) of this section are satisfied. A taxpayer to which this section applies may, however, change its annual accounting period without securing the prior approval of the Commissioner if the taxpayer can establish a substantial business purpose for the change under paragraph (c) of this section and agrees to all of the applicable conditions set forth in paragraph (d) of this section.

(c) *Substantial business purpose.*—(1) *General rule.* Except as provided in paragraph (c) (4) of this section, a taxpayer generally can establish a substantial business purpose under this paragraph (c) for a change of annual accounting period to any taxable year that meets the requirements of paragraph (c)(2) of this section. If more than one taxable year meets the requirements of paragraph (c)(2), however, a taxpayer can establish a substantial business purpose under this paragraph (c) only for a change to the year that yields the highest percentage when the percentages (rounded to the nearest 1/100 of a percent) obtained under paragraph (c)(2) of this section are averaged.

(2) *Mechanical test.* A taxable year meets the requirements of this paragraph (c)(2) only if, for the most recent 12-month period (determined at the time the statement or application required to effect or request the change is filed) ending with the last month of the requested taxable year and for each of the two preceding 12-month periods ending with the corresponding month—

(i) The gross receipts from sales or services for the last two months of such 12-month period equal or exceed 25 percent of—

(ii) The gross receipts from sales or services for such 12-month period.

(3) *Special rules.*—(i) *Gross receipts.* For purposes of this section, gross receipts from sales or services shall be determined using the taxpayer's method of accounting.

(ii) *52-53-week taxable year.* If the requested year is a 52-53-week taxable year, the calendar month ending nearest to the last day of the 52-53-week taxable year shall be treated for purposes of paragraph (c)(2) of this section as the last month of the requested year.

(iii) *Taxpayers not in existence for three 12-month periods.* If a taxpayer has not been in existence for the three 12-month periods described in paragraph (c)(2) of this section, the requirements of paragraph (c)(2) of this section may be satisfied by taking into account the gross receipts from sales and services of a predecessor organization (within the meaning of section 4.04 of Rev. Proc. 83-25) that was actively engaged in a trade or business at all times during the portion of the three applicable 12-month periods prior to the inception of the taxpayer. Thus, a taxpayer in existence for only the most recent applicable 12-month period may use the gross receipts of a predecessor organization for the two preceding 12-month periods.

(4) *Exceptions.* The following taxpayers cannot establish a substantial business purpose for a change of annual accounting period under this section solely by satisfying the requirements of this paragraph (c), and, thus, must secure the prior approval of the Commissioner to the change:

(i) A partner of a partnership;

(ii) A partnership in which any partner is a partnership or S corporation;

(iii) A beneficiary of a trust or estate;

(iv) A United States shareholder of a controlled foreign corporation; and

(v) A shareholder of a DISC or former DISC.

(5) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples.

Example (1). Assume that X, a calendar year corporation that is not described in paragraph (c)(4) of this section, wishes to change its annual accounting period to a fiscal year that ends on November 30. If the change is permitted under this section, the short period involved in the change would end on November 30, 1986. Under paragraph (f) of this section, X must attach a statement to its income tax return for the short period ending November 30, 1986, in order to effect the change. For purposes of paragraph (c)(2) of this section, the most recent 12-month period ending with the last month of the requested taxable year (November), determined as of the time the statement required to effect the change is filed, is the period that begins on December 1, 1985, and ends on November 30, 1986. The two preceding 12-month periods ending with the corresponding month are the periods from December 1, 1984, through November 30, 1985, and from December 1, 1983, through November 30, 1984.

Example (2). Assume that X, a calendar year corporation that is not described in paragraph (c)(4) of this section, wishes to change its annual accounting period to a fiscal year that ends on September 30. Assume that the most recent 12-month period determined under paragraph (c)(2) of this section is the period from October 1, 1985, through September 30, 1986, and that the two preceding 12-month periods are the periods from October 1, 1984, through September 30, 1985, and from October 1, 1983, through September 30, 1984.

Assume that the gross receipts from sales or services for the last two months of the 12-month periods ending on September 30, 1986, September 30, 1985, and September 30, 1984, are \$3,500, \$3,125, and \$2,500, respectively. Assume further that the total gross receipts for the 12-month periods ending on September 30, 1986, September 30, 1985, and September 30, 1984, are \$12,500, \$12,000, and \$10,000, respectively. The following percentages are obtained for the 12-month periods ending on September 30, 1986, September 30, 1985, and September 30, 1984, when the gross receipts for the last two months of each period are divided by the total gross receipts for that 12-month period: 28.00% (\$3,500/\$12,500), 26.04% (\$3,125/\$12,000), and 25.00% (\$2,500/\$10,000). Thus, the requirements of paragraph (c)(2) of this section are satisfied since each of those percentages equals or exceeds 25%.

Example (3). Assume the same facts as in example (2) except that X wishes to change its annual accounting period to a fiscal year that ends on July 31. In addition, assume that the percentages obtained for purposes of paragraph (c)(2) of this section with respect to a fiscal year that ends on July 31 are 26.00%, 25.00%, and 25.00%. Under paragraph (c)(1) of this section, X can establish a substantial business purpose only for a fiscal year that ends on September 30 since the average of the percentages obtained under paragraph (c)(2) of this section with respect to that year (26.35%) exceeds the average of the percentages obtained with respect to a fiscal year that ends on July 31 (25.33%).

(d) *Conditions.* The requirements of this section are in addition to any

applicable conditions under sections 441, 442, 443, 706, and 1378. Thus, for example, a taxpayer must annualize income for the short period involved in a change of annual accounting period to which this section applies if required to do so under section 443(b). The following additional conditions apply under this section to any change of annual accounting period made by a corporation (other than an S corporation) without the prior approval of the Commissioner:

(1) If the taxpayer has a net operating loss as defined in section 172 for the short period involved in the change, that net operating loss must be deducted ratably over a six-year period beginning with the first taxable year after the short period unless—

(i) The net operating loss resulting from the short period is \$10,000 or less, or

(ii) The net operating loss results from a short period of nine months or longer and is less than the net operating loss for a full 12-month period beginning with the first day of the short period.

(2) If the taxpayer has an unused credit for the short period, the taxpayer must carry the unused credit forward. Unused credits from the short period may not be carried back.

(3) The taxpayer may not make an election to be treated as an S corporation that would be effective for the taxable year immediately following the short period.

(e) *Prior approval of the Commissioner.*—(1) *In general.* The Commissioner will not consider a request for approval to a change of annual accounting period under this section unless—

(i) The taxpayer is described in paragraph (c)(4) of this section and the taxable year to which the taxpayer wishes to change meets the requirements of paragraph (c)(1) of this section, or

(ii) The taxpayer has experienced a substantial acquisition or divestiture, as defined in paragraph (e)(2) of this section.

(2) *Substantial acquisition or divestiture.*—(i) *In general.* For purposes of this paragraph (e), a taxpayer has not experienced a substantial acquisition or divestiture unless—

(A) The taxpayer has acquired or disposed of a block of assets on or after the first day of the taxable year immediately preceding the short period involved in the change of annual accounting period,

(B) At all times during the applicable 12-month periods (as defined in

paragraph (e)(2)(iii) of this section), including any period during which the assets were not held by the taxpayer, the assets were segregated, whether in a separate branch or division or otherwise, so that the gross receipts attributable to those assets can be identified, and

(C) The requirements of paragraph (e)(2)(ii) of this section are satisfied. If a taxpayer has experienced a substantial acquisition or divestiture it is anticipated that the Commissioner will usually approve a change of annual accounting period to a taxable year that would meet the requirements of paragraph (c)(1) of this section if pro-forma gross receipts (*i.e.*, gross receipts that would have resulted if the acquisition or divestiture had taken place at the beginning of the earliest applicable 12-month period) were substituted for the gross receipts described in paragraph (c)(2) of this section. The failure of a requested taxable year to meet the requirements of paragraph (c)(1) when pro-forma gross receipts are used, however, will not prevent the Commissioner from approving the change.

(ii) *Mechanical test.* A taxpayer has experienced a substantial acquisition or divestiture for purposes of this paragraph (e) only if—

(A) The aggregate of the gross receipts from sales and services (within the meaning of paragraph (c)(3)(i) of this section) for the applicable 12-month periods attributable to the acquired or divested assets (including receipts for any period during which the assets were not held by the taxpayer), exceeds 80 percent of—

(B) The aggregate of the gross receipts from sales and services (within the meaning of paragraph (c)(3)(i) of this section) of the taxpayer for the applicable 12-month periods, determined without taking into account the gross receipts from sales and services attributable to the acquired or divested assets.

(iii) *Applicable 12-month periods.* For purposes of this paragraph (e)(2), the term "applicable 12-month periods" means—

(A) In the case of an acquisition, the 12-month period described in paragraph (c)(2) of the section; and

(B) In the case of divestiture, the 12-month periods described in paragraph (c)(2) of this section that end before the date of the divestiture.

(iv) *Example.* The provisions of this paragraph (e) may be illustrated by the following example.

Example. Assume that X, a calendar year corporation, wishes to change its annual

accounting period to a fiscal year ending October 31, 1986. Assume that on January 1, 1986, X acquired from corporation Y a block of assets that Y held in a separate division and that X also holds in a separate division. Assume that the most recent 12-month period described in paragraph (c)(2) of this section is the period that begins on November 1, 1985, and ends on October 31, 1986, and that the two preceding 12-month periods are the periods from November 1, 1984 through October 31, 1985, and from November 1, 1983, through October 31, 1984. Assume that the gross receipts attributable to the assets acquired from Y for the 12-month period ending October 31, 1986 (including the receipts attributable to the period from November 1, 1985, through December 31, 1985, when the assets were held by Y, and the receipts attributable to the period from January 1, 1986, through October 31, 1986, when the assets were held by X), are \$8,000. In addition, assume that the gross receipts attributable to the assets acquired from Y for the 12-month periods ending October 31, 1985, and October 31, 1984, when the assets were held by Y, are \$7,500, and \$7,000, respectively. Assume further that X's gross receipts from sales and services for the 12-month period ending October 31, 1986, October 31, 1985, and October 31, 1984, without taking into account gross receipts attributable to the assets acquired from Y, are \$10,000, \$9,000, and \$8,000, respectively. The requirements of paragraph (e)(2)(ii) of this section are satisfied since \$22,500 (\$8,000 + \$7,500 + \$7,000) exceeds 80 percent of \$27,000 (\$10,000 + \$9,000 + \$8,000). Thus, the Commissioner will consider X's request to change its taxable year to a fiscal year ending October 31, 1986.

(f) *Procedures.*—(1) *Changes not requiring the prior approval of the Commissioner.* In order to effect a change that does not require the prior approval of the Commissioner under this section, a taxpayer must indicate that the requirements of this section are satisfied in a statement setting forth the computations required to establish a substantial business purpose under paragraph (c) of this section. The statement also must indicate that the taxpayer has agreed to all of the applicable conditions to the change, including any applicable conditions contained in § 1.441-3T. A taxpayer (other than an corporations seeking S status) must attach the statement to the income tax return for the short period involved in the change and, in addition, must type or legibly print the following caption at the top of page 1 of the return: "FILED UNDER § 1.442-2T (f)(1)." In the case of a corporation seeking S status, the statement must be attached to Form 2553 and the caption "FILED UNDER § 1.442-2T (f)(1)" must be typed or printed legibly at the top of page 1 of Form 2553.

(2) *Changes requiring the prior approval of the Commissioner.* In the

case of a change of annual accounting period that requires the prior approval of the Commissioner under this section, a taxpayer must file Form 1128 or Form 2553, whichever is applicable. (See paragraph (e)(1) of this section for situations in which a request for approval will be considered.) The taxpayer must indicate that the application is filed under this paragraph (f)(2) by typing or printing legibly the following caption at the top of page 1 of the Form 1128 or Form 2553: "FILED UNDER § 1.442-2T (f)(2)." The taxpayer also must attach a statement to the applicable form setting forth the computations described in paragraph (c) of this section. In addition, a taxpayer described in paragraph (e)(1) (ii) of this section must attach a statement setting forth the computations described in paragraph (e)(2) of this section.

(3) *Time for filing.* (i) Except as otherwise provided in paragraph (f)(3) (ii) of this section, a taxpayer cannot change its annual accounting period under this section unless the return or form required to effect or request the change is filed by its due date (with extensions if the change is effected by filing an income tax return for the short period involved in the change).

(ii) A taxpayer may change its annual accounting period under this section if the due date (without regard to extensions) for the return or form required to effect or request the change is on or after September 30, 1986, and before March 9, 1987 and the return or form is filed before March 9, 1987 (or, in the case of a change effected by filing an income tax return for the short period involved in the change, if an application for extension is filed before March 9, 1987. This paragraph only extends the time for changing an annual accounting period and does not extend the time for making a S election. An S election that is timely filed before March 9, 1987, however, will not be denied or rendered ineffective solely by reason of the need for the taxpayer to submit the information required by paragraph (f)(1) or (f)(2) of this section.

(iii) In the case of a change of annual accounting period under this section that is effected by filing an income tax return for the short period involved in the change, any failure to file a return or to pay tax on or before the due date for the return or the date prescribed for payment will be treated as due to reasonable cause and will not give rise to any addition to tax under section 6651 if—

(A) The due date for the return (without regard to extensions) or the date prescribed for payment is on or

after September 30, 1986, and before March 9, 1987, and

(B) The return (or application for extension) is filed and the tax is paid before March 9, 1987.

(g) *Effective date*—(1) *In general*. This section shall apply to a change of annual accounting period (other than a change described in paragraph (g)(2) of this section) if—

(i) The income tax return for the short period involved in the change is filed after September 29, 1986, and

(ii) The short period involved in the change ends before January 5, 1987.

(2) *Exceptions*. This section shall not apply to a change of annual accounting period if the application required to effect or request the change was timely filed before September 30, 1986. In the case of a change that is effected by filing an income tax return for the short period involved in the change, this section shall not apply if an application for extension to file that return was filed before September 30, 1986, the application clearly stated the year to which the taxpayer intended to change, and the income tax return for the short period is timely filed (determined with regard to extensions).

(3) *Hardship rule*. A taxpayer can request a waiver from the provisions of this section if the taxpayer can demonstrate, to the satisfaction of the Commissioner, that the taxpayer would sustain a substantial hardship from the application of this section, and if the short period involved in the change ends on or before October 5, 1986. A waiver ordinarily will not be granted unless the taxpayer can show that, by October 5, 1986, the taxpayer had closed its books in a manner that indicates that the period in question was intended to be the end of the short period, taken a physical inventory (if applicable), and incurred substantial costs in modifying its accounting systems (including, for example, costs of reprogramming applicable computer systems) in order to change its year. A request for a waiver under this paragraph (g)(3) must be filed with the Commissioner of Internal Revenue, 1111 Constitution Avenue, NW, Room 5040, Washington, DC 20224 by March 9, 1987. Any information submitted with the request for waiver shall be submitted under penalties of perjury.

(h) *Anti-abuse rule*—(1) *In general*. A taxpayer may not adopt any taxable year that has the effect of circumventing the provisions of this section. The provisions of this section are deemed to be circumvented if, for example, a taxpayer that is unable to change its taxable year under this section transfers a substantial portion of its net assets to

a related person and the related person purportedly adopts the desired taxable year. In that case, purported adoption of the desired taxable year will not be given effect and the related person must adopt the same taxable year as that of the taxpayer that is unable to change its taxable year under this section. For this purpose, the term "related person" has the same meaning as in section 168(e)(4)(D) (as in effect prior to the enactment of the Tax Reform Act of 1986), except that the second sentence thereof (relating to the substitution of 10 percent for 50 percent in applying sections 267(b) and 707(b)(1)) shall be disregarded.

(2) *Example*. The provisions of paragraph (h)(1) of this section may be illustrated with the following example.

Example. Assume that X, a calendar year corporation, is subject to the restrictions on changes in annual accounting period under this section. Assume that X wishes to change its taxable year to a fiscal year ending November 30, 1986, but cannot do so because it does not meet the requirements of this section. Assume further that X creates corporation Y, a wholly-owned subsidiary of X, which purportedly adopts a taxable year ending November 30, 1986. In addition, assume that X transfers a substantial portion of its net assets to Y before November 30, 1986, in a transaction described in section 351 or 368. Under these facts, Y may not adopt a November 30 taxable year and instead must adopt a taxable year that ends on December 31, which is the taxable year of X.

Par. 6. Section 1.442-3T is added at the appropriate place:

§ 1.442-3T Special limitations on certain adoptions and retentions of a taxable year.

(a) *Applicability*. This section generally applies to—

(1) Any partnership that wishes to adopt a taxable year other than the calendar year, the taxable year of its principal partners, or the taxable year to which all of its principal partners are concurrently changing, and

(2) Any corporation seeking S status that wishes to adopt or retain a taxable year other than the calendar year or a taxable year that meets the requirements of § 4.02 or 4.04 of Rev. Proc. 83-25, 1983-1 C.B. 689.

(b) *General rule*. A taxpayer to which this section applies may not adopt or retain a taxable year that results in any deferral of income to its partners or shareholders unless the taxpayer—

(1) Secures the prior approval of the Commissioner by establishing a substantial business purpose under paragraph (c)(2) of this section for the adoption or retention, or

(2) Is permitted to adopt or retain the taxable year without securing the prior

approval of the Commissioner under paragraph (c)(1) of this section.

Thus, a taxpayer to which this section applies may not adopt or retain a taxable year that results in a deferral of income to its partners or shareholders under Rev. Proc. 72-51, 1972-2 C.B. 832, or § 4.03 of Rev. Proc. 83-25, 1983-1 C.B. 689.

(c) *Substantial business purpose*—(1) *Prior approval of the Commissioner not needed*. Notwithstanding § 1.706-1(b), § 1.442-1(b)(2), and 26 CFR 18.1378-1(a), a taxpayer to which this section applies may adopt or retain a taxable year that results in a deferral of income to its partners or shareholders without the prior approval of the Commissioner if the taxpayer can establish a substantial business purpose under § 1.442-2T(c). Thus, a taxpayer described in § 1.442-2T(c)(4) must secure the prior approval of the Commissioner to the adoption or retention even if the requirements of § 1.442-2T(c)(1) are satisfied. A taxpayer shall effect an adoption or retention permitted under this paragraph (c)(1) in the manner prescribed by § 1.442-2T(f)(1), except that the taxpayer's first income tax return shall be treated as the return for the short period involved in a change of annual accounting period.

(2) *Prior approval of the Commissioner*. In any case where the taxpayer was in existence for the three 12-month periods described in § 1.442-2T(c)(2), or where a predecessor organization (within the meaning of § 4.04 of Rev. Proc. 83-25) was actively engaged in a trade or business at all times during the portion of those three 12-month periods prior to the inception of the taxpayer, the Commissioner will consider a request for prior approval of an adoption or retention of a taxable year that results in a deferral of income to its partners or shareholders only if the taxpayer is described in § 1.442-2T(e). In such a case, the application for approval shall be filed in the manner prescribed by § 1.442-2T(f)(2). In any other case, the taxpayer must establish a substantial business purpose in order to obtain the prior approval of the Commissioner, and must file an application for approval in accordance with § 1.706-1(b) or 26 CFR 18.1378-1(a) (whichever is applicable) and § 1.442-1T(b)(1). For this purpose, the following factors generally will not be sufficient to establish a substantial business purpose:

(i) The use of a particular year for regulatory or financial accounting purposes;

(ii) The hiring patterns of a particular business (e.g., the fact that a firm

typically hires staff during certain times of the year):

(iii) The use of a particular year for administrative purposes, such as for the admission or retirement of partners or shareholders, promotion of staff, and compensation or retirement arrangements with staff, partners, or shareholders; and

(iv) The fact that a particular business involves the use of price lists, model year, or other items that change on an annual basis.

(d) *Time for filing.* (1) Except as otherwise provided in paragraph (d)(2) of this section, a taxpayer cannot adopt or retain a taxable year under this section unless the return or form required to effect or request the adoption or retention is filed by its due date (with extensions if the adoption is effected by filing an income tax return for the taxpayer's first taxable year).

(2) A taxpayer may adopt or retain a taxable year under this section if the due date (without regard to extensions) for the return or form required to effect or request the adoption or retention is on or after November 6, 1986, and before March 9, 1987, and the return or form is filed before March 9, 1987 (or, in the case of an adoption effected by filing an income tax return for the taxpayer's first taxable year, if an application for extension is filed before March 9, 1987). This paragraph (d)(2) only extends the time for adopting or retaining a taxable year and does not extend the time for making an S election. An S election that is timely filed before March 9, 1987, however, will not be denied or rendered ineffective solely by reason of the need for the taxpayer to submit the information required by paragraph (c) of this section.

(3) In the case of an adoption or retention of a taxable year under this section that is effected by filing an income tax return for the taxpayer's first taxable year, any failure to file a return or to pay tax on or before the due date for the return or the date prescribed for payment will be treated as due to reasonable cause and will not give rise to any addition to tax under section 6651 if—

(i) The due date for the return (without regard to extensions) or the date prescribed for payment is on or after November 6, 1986, and before March 9, 1987, and

(ii) The return (or application for extension) is filed and the tax is paid before March 9, 1987.

(e) *Effective date.* This section generally applies if the first taxable year of the partnership or the first taxable year for which the election to be an S corporation is effective begins before

January 1, 1987, unless the application necessary to effect or request the adoption or retention was timely filed before November 6, 1986. This section shall not apply, however, to an adoption by a partnership of a taxable year that begins before January 1, 1986.

Par. 7. Section 1.706-1 is amended by adding the following new paragraph (b)(7):

§ 1.706-1 Taxable years of partner and partnership.

*(b) Adoption or change in taxable year.***

(7) *Cross-reference to § 1.442-2T and § 1.442-3T.* For special rules applicable to certain changes in annual accounting period where the short period involved in the change ends in 1986 or 1987, see § 1.442-2T. For special rules applicable to certain adoptions and retentions of a taxable year ending in 1986 or 1987, see § 1.442-3T.

PART 18—TEMPORARY INCOME TAX REGULATIONS UNDER THE SUBCHAPTERS S REVISION ACT OF 1982

Par. 8. The authority for Part 18 continues to read in part as follows:

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

Par. 9. Section 18.1378-1 is amended by adding the following new paragraph (e) at the end thereof:

§ 18.1378-1 Taxable year of S corporation.

*(e) *Cross-reference to § 1.442-2T and § 1.442-3T.* For special rules applicable to certain changes in annual accounting period where the short period involved in the change ends in 1986 or 1987, see § 1.442-2T. For special rules applicable to certain adoptions and retentions of a taxable year ending in 1986 or 1987, see § 1.442-3T.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 10. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

Par. 11. Section 602.101 (c) is amended by inserting in the appropriate places in the table "§ 1.441-3T ... 1545-0134", "§ 1.442-2T ... 1545-0134", and "§ 1.442-3T ... 1545-0134."

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractical 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.

James I. Owens,

Acting Commissioner of Internal Revenue.

Approved: January 15, 1987.

O. Donaldson Chapoton,

Acting Assistant Secretary of the Treasury.

[FR Doc. 87-2016 filed 2-4-87; 8:45 am]

BILLING CODE 4830-01-M

26 CFR Parts 5h and 602

[T.D. 8124]

Income Tax; Certain Elections Under the Tax Reform Act of 1986

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the time and manner of making certain elections under the Tax Reform Act of 1986. These regulations provide guidance to persons making these elections.

DATES: These regulations are effective February 5, 1987. Except as otherwise provided, the regulations apply to elections made after October 22, 1986.

FOR FURTHER INFORMATION CONTACT: Joel S. Rutstein of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., NW., Washington, D.C. 20224, (Attention: CC:LR:T (LR-77-86). Telephone 202-566-3297 (not a toll free call).

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary regulations relating to certain elections under various sections of the Internal Revenue Code of 1986 and the Tax Reform Act of 1986 (the Act). These regulations are added to the Temporary Regulations—Elections Under Various Public Laws (26 CFR Part 5h). The temporary regulations provided by this document will remain in effect until superseded by later temporary or final regulations relating to these elections.

Explanation of Provisions

Section 5h.5(a)(1) lists certain elections that are provided by the Act and are addressed in this regulation. The general rules (and exceptions thereto) regarding the time for making the listed elections are provided in

§ 5h.5(a)(2). The general rules (and exceptions thereto) regarding the manner of making the listed elections are provided in § 5h.5(a)(3). Special rules regarding the time and manner for making certain elections listed in § 5h.5(a)(1) are contained in paragraphs (b) through (i) of § 5h.5. Election provisions provided by the Act, but not addressed in this regulation, will be addressed in other regulation projects.

Section 5h.5(j) provides that additional information may be required from taxpayers after an election has been filed.

Special Analysis

The Commissioner of Internal Revenue has determined that this temporary regulation is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

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).

The collection of information requirements contained in this regulation 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 under control number 1545-0982.

Drafting Information

The principal author of these regulations is Joel S. Rutstein 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 both on matters of substance and style.

List of Subjects

26 CFR Part 5h

Income taxes, Elections under various public laws, Deficit Reduction Act of 1984, Tax Reform Act of 1986.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulation

Accordingly, 26 CFR Parts 5h and 602 are amended as follows:

PART 5h—[AMENDED]

Paragraph 1. The authority for Part 5h continues to read:

Authority: 26 U.S.C. 7805, section 5h.5 also issued under 26 U.S.C. 42(f)(1), 42(g)(1), 42(i)(2), 42(j)(5), 48(b)(2), 56(f)(3)(B), 83(c)(3), 141(b)(9), 142(d)(1), 142(d)(4)(B), 143(k)(9)(D)(iii), 154(d), 147(b)(4)(A), 165(l)(1), 168(b)(5), 168(f)(1), 168(g)(7), 168(h)(6)(F)(ii), 216(b)(3), 263(i), 263A(d)(3), 382(l)(5)(H), 448(d)(4), 453C(b)(2)(B), 453C(e)(4), 468B,

469(j)(9), 474, 585(c)(3)(A)(iii)(1), 585(c)(4), 616(d), 617(h), 1059(c)(4), 2632(b)(3), 2652(a)(3), 3121(w)(2), 4982(e)(4), and 7701(b). Section 5h.5 also issued under Pub. L. 99-514 sections 203(a)(1)(B), 204(e), 243(a), 243(b), 311(d)(2), 646, 801(d)(2), 806(e)(2)(c), 905(c), 1704(b), 1801(a), 1802(a), and 1804(e)(4).

Par. 2. A new § 5h.5 is added immediately after § 5h.4 to read as follows:

§ 5h.5 Time and manner of making the elections under the Tax Reform Act of 1986.

(a) *Miscellaneous elections*—(1) *Elections to which this paragraph applies.* This paragraph applies to the elections set forth below provided under the Tax Reform Act of 1986 (the Act). General rules regarding the time for making the elections are provided in paragraph (a)(2) of this section. General rules regarding the manner for making certain elections are provided in paragraph (a)(3) of this section. Special rules regarding the time and manner for making certain elections are contained in paragraphs (a)–(i) of this section. If a special rule applies to one of the elections listed below, a cross-reference to the special rule is shown in brackets at the end of the description of the "Availability of Election." Paragraph (j) of this section provides that additional information with respect to elections may be required by future regulations or revenue procedures.

Section of Act	Section of Code	Description of Election	Availability of Election
201(a)	168(b)(5)	Election to depreciate property using the straight line method of recovery with respect to one or more classes of property for any taxable year	Property placed in service after 12-31-86. Election must be made for taxable year in which property is placed in service. Election shall apply to all property in the class placed in service during the taxable year for which the election is made.
201(a)	168(f)(1)	Election to exclude certain property from the accelerated cost recovery system	Property placed in service after 12-31-86. Election must be made for taxable year in which property is placed in service.
201(a)	168(g)(7)	Election to use alternative depreciation system with respect to one or more classes of property for any taxable year (except for residential rental or non-residential real property where the election may be made separately with respect to each property)	Property placed in service after 12-31-86. Election must be made for taxable year in which property is placed in service. Except for residential rental or non-residential real property, election shall apply to all property in the class placed in service during the taxable year for which the election is made.
201(a), 1802(a)	168(h)(6)(F)(ii), 168(j) (as in effect before October 22, 1986)	Election by a tax-exempt controlled entity to treat any gain recognized by the tax-exempt parent on any disposition of an interest in the tax-exempt controlled entity (and to treat any dividends or interest received or accrued from the tax-exempt controlled entity) as unrelated business taxable income under Code section 511 in order for the tax-exempt controlled entity to not be treated as a tax-exempt entity (or as a successor to a tax-exempt entity)	Property placed in service after 9-27-85, but can apply to property placed in service before such date if the tax-exempt controlled entity so elects. [See paragraph (a)(3)(ii) of this section.]
203(a)(1)(B)		Election to apply Act section 201 (including all elections within section 201)	Property placed in service after 7-31-86 and before 1-1-87.
204(e)		Election to have Act section 201 either (i) not apply to any property placed in service during 1987 or 1988 which is replacement property for property lost, damaged or destroyed in a flood which occurred 11-3-86 through 11-7-85 and which was declared a natural disaster area by the President of the United States, or (ii) apply to all such replacement property placed in service during 1985 or 1986	(i) Property placed in service during 1987 or 1988; or (ii) property placed in service during 1985 or 1986.
243(a)		Election to begin the 60 month amortization period with the first month of the taxpayer's first taxable year beginning after 11-19-82 in lieu of the 11-19-82 date or the bus operating authority acquisition date	Bus operating authorities held on 11/19/82; or acquired after that date under a written contract that was binding on that date.

Section of Act	Section of Code	Description of Election	Availability of Election
243(b)		Election to begin the 60 month amortization period on the first month of the taxpayer's first taxable year beginning after the deregulation month in lieu of the deregulation month	Freight forwarder operating authorities held at the beginning of the 60 month period applicable to the taxpayer (i.e., the deregulation date or the first month of the first taxable year beginning after the deregulation date).
243 (a), (b)		Election by a qualified corporate taxpayer to allocate a portion of the cost basis of a qualified acquiring corporation in the stock of an acquired corporation to the basis of the authority	For bus operating authorities: authorities held on 11/19/82, or acquired after that date under a written contract that was binding on that date. For freight forwarders: authorities held at the beginning of the 60-month period applicable to the taxpayer.
252(a)	42(f)(1)	Election concerning beginning of credit period for low-income housing credit	Buildings placed in service after 12-31-86 and before 1-1-90 (before 1-1-91 for buildings described in Code section 42(n)(2)(B)). [See paragraph (b) of this section.]
252(a)	42(g)(1)	Election concerning qualified low-income housing project to either satisfy the 20-50 or the 40-60 occupancy test	Buildings placed in service after 12-31-86 and before 1-1-90 (before 1-1-91 for buildings described in Code section 42(n)(2)(B)). [See paragraph (b) of this section.]
252(a)	42(i)(2)	Election to reduce eligible basis by outstanding balance of Federal loan subsidy	Buildings placed in service after 12-31-86 and before 1-1-90 (before 1-1-91 for buildings described in Code section 42(n)(2)(B)). [See paragraph (b) of this section.]
252(a)	42(j)(5)	Election to have certain partnerships treated as the taxpayer eligible for low-income housing credit	Buildings placed in service after 12-31-86 and before 1-1-90 (before 1-1-91 for buildings described in Code section 42(n)(2)(B)). [See paragraph (b) of this section.]
311(d)(2)		Revocation of prior election under Code section 631(a)	Election for taxable years beginning before 1-1-87 may be revoked for taxable years ending after 12-31-86.
411(b)(1)	263(i)	For intangible drilling and development costs paid or incurred with respect to an oil, gas, or geothermal well located outside the United States, election to include such costs in adjusted basis for purposes of computing the amount of any deduction under Code section 611 (without regard to section 613).	Costs paid or incurred after 12-31-86 in taxable years ending after such date. [See paragraph (a)(2)(iii) of this section.]
411(b)(2)	616(d)	For expenditures paid or incurred with respect to the development of a mine or other natural deposit (other than an oil, gas, or geothermal well) located outside the United States, election to include such expenditures paid or incurred during the taxable year for which made in adjusted basis for purposes of computing the amount of any deduction under Code section 611 (without regard to section 613).	Costs paid or incurred after 12-31-86 in taxable years ending after such date. [See paragraph (a)(2)(iv) of this section.]
411(b)(2)	617(h)	For expenditures paid or incurred before the development stage for the purpose of ascertaining the existence, location, extent or quality of any deposit of ore or other mineral deposit (other than an oil, gas or geothermal well) located outside the United States, election to include all such expenditures, paid or incurred during the taxable year with respect to any such deposit, in adjusted basis for purposes of computing the amount of any deduction under Code section 611 (without regard to section 613).	Costs paid or incurred after 12-31-86 in taxable years ending after such date. [See paragraph (a)(2)(v) of this section.]
501(a)	469(j)(9)	Election to increase basis of property by amount of disallowed credit for purposes of determining gain or loss from a disposition of property used in a passive activity	Taxable years beginning after 12-31-86. [See paragraph (a)(3)(iii) of this section.]
614(b)	1059(c)(4)	Election to determine whether a dividend is extraordinary by reference to the fair market value of the share of stock with respect to which the dividend was received	Dividends declared after July 18, 1986 in taxable years ending after such date.
621(a)	382(f)(5)(H)	Election by certain new loss corporations not to apply the special rules of Code section 382(l)(5) concerning inapplicability of the section 382(a) limitation on corporate net operating loss carryforwards where the old loss corporation is involved in a Title 11-type case	Ownership changes following either an owner shift involving a 5% shareholder occurring after 12-31-86 or an equity structure shift occurring pursuant to a plan of reorganization adopted after 12-31-86.
644(d)	216(b)(3)	Election by a cooperative housing corporation to allocate real estate taxes or interest or both to each tenant-stockholder's dwelling unit in a manner which reasonably reflects the cost to the corporation of the tenant-stockholder's dwelling unit	Taxable years beginning after 12-31-86. [See paragraph (a)(3)(iv) of this section.]
646		Election by an entity to be treated as a trust under the Internal Revenue Code if such entity was created in 1906 as a common law trust and governed by the trust laws of the State of Minnesota, receives royalties from iron ore leases, and income interests in the entity are publicly traded on a national stock exchange	The election is effective beginning on first day of the first taxable year beginning after October 22, 1986 and following the year in which the election is made. Such election must be made by the board of trustees of such entity and must be accompanied by a written agreement signed by the board of trustees of the entity.
651	4982(e)(4)	Election by a regulated investment company to use taxable years ending on 11-30 or 12-31 for purposes of computing capital gain net income under Code section 4982	Calendar years beginning after 12-31-86. [See paragraph (a)(2)(vi) of this section.]
701(a)	56(f)(3)(B)	Election to have amount of net book income be equal to amount earnings and profits	Taxable years beginning after 12-31-86.
801(a)	448(d)(4)	Election of common parent of an affiliated group that all members of such group be treated as one taxpayer if substantially all the activities of all members of the affiliated group involve performance of services in the same field	Taxable years beginning after 12-31-86.
801(d)(2)		Election to continue using the cash method of accounting for loans, leases and related party transactions	Loans, leases and related party transactions entered into before 9-26-85.
802	474	Election by certain small businesses to use the simplified dollar-value LIFO method	Taxable years beginning after 12-31-86. [See paragraph (a)(3)(v) of this section.]
803(a)	263A(d)(3)	Election to have rules of Code section 263A (relating to capitalization and inclusion in inventory costs of certain expenses) not apply to any plant or animal produced in any farming business conducted by the electing taxpayer	Unless consent is obtained from the Commissioner, the first taxable year beginning after 12-31-86 during which the taxpayer engages in a farming business. [See paragraph (c) of this section.]
806(e)(2)(C)		Election to have net income for the short taxable year of a partnership or S corporation which results from the required change in accounting period included entirely in income for such short taxable year	Partner and shareholder taxable years beginning after 12-31-86 with or within which the short taxable year created under section 806 of the Act ends. [See paragraph (d) of this section.]

Section of Act	Section of Code	Description of Election	Availability of Election
		Election to reduce partnership or S corporation income for the short taxable year resulting from a required change in accounting period under section 806 of the Act by an unamortized adjustment amount existing as of October 22, 1986, where such adjustment was required to effectuate a previous accounting period change under Rev. Proc. 72-51, 1972-2 C.B. 832 or Rev. Proc. 83-25, 1983-1 C.B. 689	Short taxable years of partnerships or S corporations beginning after 12-31-86 [See paragraph (e) of this section.]
811(a)	453C(b)(2)(B)	Election to compute adjusted bases using depreciation deduction used under Code section 312(k)	Taxable years ending after 12-31-86 with respect to dispositions made after 2-28-86.
811(a)	453C(e)(4)	Election to have Code section 453C not apply to obligations arising from sales of timeshares and unimproved residential lots to individuals	Taxable years ending after 12-31-86 with respect to dispositions made after 2-28-86. [See paragraph (a)(3)(vi) of this section.]
901(a)	585(c)(3)(A)(iii)(i)	Election to recapture more than 10% of the bad debt reserve in the first taxable year after the disqualification year	Taxable years beginning after 12-31-86.
901(a)	585(c)(4)	Election to use the "cut-off method" to recapture bad debt reserves	Taxable years beginning after 12-31-86.
905(a)	165(j)(1)	Election to treat amount of reasonably estimated loss on a deposit in insolvent or bankrupt qualified financial institution as a loss described in Code section 165(c)(3) and incurred in the taxable year	Taxable years beginning after 12-31-82. [See paragraph (f) of this section.]
905(c)		Election to apply Code section 451(f) (relating to treatment of interest on frozen deposits in certain financial institutions)	Taxable years beginning after 12-31-82 and before 1-1-87.
1301(b)	141(b)(9)	Election by issuer of tax-exempt bonds to treat a portion of an issue as a qualified 501(c)(3) bond if such portion would have qualified as a 501(c)(3) bond had it been issued separately	Bonds issued after 8-15-86. [See paragraph (g) of this section.]
1301(b)	142(d)(1)	Election by issuer of tax-exempt bonds for residential rental property to satisfy either the 20-50 or the 40-60 occupancy test	Bonds issued after 8-15-86. [See paragraph (g) of this section.]
1301(b)	142(d)(4)(B)	Election by issuer of tax-exempt bonds for residential rental property to treat the project as a deep rent skewed project	Bonds issued after 8-15-86. [See paragraph (g) of this section.]
1301(b)	143(k)(9)(D)(iii)	Election to treat limited equity cooperative housing as residential rental property and not as owner-occupied housing	Bonds issued after 8-15-86 and before 1-1-89. [See paragraph (g) of this section.]
1301(b)	145(d)	Election by issuer of tax-exempt bonds to have Code section 145 not apply to the issue if the issue is an issue of exempt facility bonds or qualified redevelopment bonds, to which the volume cap applies	Bonds issued after 8-15-86. [See paragraph (g) of this section.]
1301(b)	147(b)(4)(A)	Election by issuer of qualified 501(c)(3) bonds to have such bonds treated as meeting the limitation on maturity requirements of Code section 147(b)(1) if the requirements of section 147(b)(4)(B) are met	Bonds issued after 8-15-86. [See paragraph (g) of this section.]
1431(a)	2632(b)(3)	Election to not allocate generation skipping transfer exemption to a direct skip transfer	Generation skipping transfers made, or treated as made, after October 22, 1986.
1431(a)	2652(a)(3)	Election to have qualified terminable interest property election not apply for purposes of the generation skipping transfer tax	Generation skipping transfers made, or treated as made, after October 22, 1986.
1704(b)		Election to revoke prior election under Code section 1402(e) (relating to exemption from social security taxes for certain clergy)	Remuneration received in taxable years ending on or after October 22, 1986. [See paragraph (h) of this section.]
1801(a)	168(i) (as in effect before October 22, 1986)	Election to make finance leasing rules inapplicable to property which would otherwise be subject to them under the transitional rules of section 12(c)(1) of the Tax Reform Act of 1984	Personal property leased under certain lease agreements effective on or after 1-1-84. [See paragraph (a)(3)(vii) of this section.]
1804(e)(4)		Election by a common parent of an affiliated group to apply amendments made by the Tax Reform Act of 1984 for taxable years beginning after 12-31-83	Groups which include a corporation which on 6-22-84 is a member of the group which files a consolidated return for such corporation's taxable year which includes 6-22-84.
1807(a)(7)	468B	Election to treat a qualified payment made to a court-ordered fund as a payment made to a designated settlement fund	Generally, liabilities arising out of personal injury, death or property damage that are incurred after 7-18-84 under law in effect before the enactment of Code section 461(h). Election is made for the taxable year in which qualified payments are made to a designated settlement fund. Property originally placed in service after 4-11-84 (as determined under Code section 48(b) prior to its amendment by section 114(a) of the Tax Reform Act of 1984). [See paragraph (a)(3)(viii) of this section.]
1809(e)(2)	48(b)(2)	Election by lessee and lessor not to apply the rule of Code section 48(b)(2) concerning the date leased property is treated as originally placed in service	Taxable years beginning after December 31, 1984. [See paragraph (a)(3)(ix) of this section.]
1810(c)(4)	7701(b)	Election to be treated as a resident alien	Transfers of stock described in section 1879(p)(1) of the Act. [See paragraph (a)(2)(viii) and (a)(3)(x) of this section.]
1879(p)(1)	83(c)(3)	Election to treat certain stock acquired upon the exercise of nonqualified stock options as subject to a substantial risk of forfeiture by reason of Code section 83(c)(3) even though the transfer of stock pursuant to such exercise occurred before 1-1-82, the effective date of section 83(c)(3)	
1882(c)	3121(w)(2)	Election to revoke prior election under Code section 3121(w) (relating to exemption from social security taxes for certain churches and qualified church-controlled organizations)	Remuneration paid after 12-31-86 unless such electing church or church-controlled organization had withheld and paid over all employment taxes due, as if such election had never been in effect during the period from the stated effective date of the election being revoked through 12-31-86. [See paragraph (j) of this section.]

(2) *Time for making elections*—(i) *In general.* Except as otherwise provided in this section, the elections specified in paragraph (a)(1) of this section shall be made by the later of—

(A) The due date (taking extensions

into account) of the tax return for the first taxable year for which the election is to be effective, or

(B) April 15, 1987 (in which case the election generally must be made by amended return).

(ii) *No extension of time for payment.* Payments of tax due shall be made in accordance with chapter 62 of the Code.

(iii) *Time for making the election with respect to foreign intangible drilling costs.* With respect to the election under

Act section 411(b)(1) (Code section 263(i)(2)(A)), the election shall be made on a property-by-property basis for each oil, gas, or geothermal property (as defined in Code section 614). The election shall be made by the due date (taking extensions into account) of the income tax return for the first taxable year in which the taxpayer pays or incurs any cost with respect to the development of such property for which the election is available.

(iv) *Time for making the election with respect to foreign development expenditures.* With respect to the election under Act section 411(b)(2) (Code section 616(d)(2)(A)), the election shall be made for each mine or other natural deposit not later than the time prescribed by law for filing the income tax return (taking extensions into account) for the taxable year to which such election is applicable.

(v) *Time for making the election with respect to foreign exploration expenditures.* With respect to the election under Act section 411(b)(2) (Code section 617(h)(2)(A)), the election may be made at any time before the expiration of the period prescribed for filing a claim for credit or refund of the tax imposed by chapter 1 of the Code for the first taxable year for which the taxpayer desires the election to be applicable.

(vi) *Time for making certain elections by regulated investment companies.* The election under Act section 651 (Code section 4982(e)(4)) shall be made on a statement attached to the form prescribed by the Internal Revenue Service which is used to report and pay the excise tax liability under such section 4982, and shall be filed on or before March 15 of the first calendar year beginning after the end of the first excise tax period for which the election is to be effective. The statement of election under section 4982(e)(4) shall be attached to the prescribed form regardless of whether the regulated investment company is liable for the excise tax imposed by section 4982 for the excise tax period in question.

(vii) *Time for making the election with respect to certain nonqualified stock options.* The election under section 1879(p)(1) of the Act (Code section 83(c)(3)) shall be made—

(A) By April 21, 1987, in any case in which the operation of any law or rule of law on or before such date would prevent the credit or refund of any overpayment of tax resulting from such election, and

(B) By no later than any date after April 21, 1987 on which the operation of

any law or rule of law would prevent the credit or refund of any overpayment of tax resulting from such election.

(3) *Manner of making elections—(i) In general.* Except as otherwise provided in this section, the elections specified in paragraph (a)(1) of this section shall be made by attaching a statement to the tax return for the taxable year for which the election is to be effective. If because of paragraph (a)(2)(i)(B) of this section the election may be filed after the due date of the tax return for the first taxable year for which the election is to be effective, such statement must be attached to a tax return or amended return for the taxable year to which the election relates. Except as otherwise provided in the return or in the instructions accompanying the return for the taxable year, the statement shall—

(A) Contain the name, address and taxpayer identification number of the electing taxpayer,

(B) Identify the election,

(C) Indicate the section of the Code (or, if the provision is not codified, the section of the Act) under which the election is made,

(D) Specify, as applicable, the period for which the election is being made and/or the property or other items to which the election is to apply, and

(E) Provide any information required by the relevant statutory provisions and any information necessary to show that the taxpayer is entitled to make the election.

(ii) *Special rules for making the transitional rule elections with respect to certain tax-exempt controlled entities.* The irrevocable election under Act sections 201(a) and 1802(a) (Code sections 168(h)(6)(F)(ii) and 168(j)), as in effect before October 22, 1986, shall be made by the tax-exempt controlled entity at the time and in the manner described in paragraphs (a)(2) and (a)(3)(i) of this section. A copy of the election statement filed by the tax-exempt controlled entity shall also be attached to the Federal tax returns (e.g., Form 990 or 5500) of each of the tax-exempt shareholders or beneficiaries of the controlled entity.

(iii) *Special rule for making the election with respect to gain or loss from a disposition of property used in a passive activity.* The election under Act section 501(a) (Code section 469(j)(9)) shall be made on the form prescribed by the Internal Revenue Service for computing the taxpayer's passive activity loss and credit for the taxable year in which the property is disposed.

(iv) *Special rules for making the election with respect to cooperative housing corporations.* The election

under Act section 644(d) (Code section 216(b)(3)(B)(ii)) may be made by a cooperative housing corporation with respect to its real estate taxes or interest or both. The election is available for any taxable year beginning after December 31, 1986, if the cooperative housing corporation has, by January 31 of the year following the first calendar year that includes any period to which the election applies, furnished to each tenant-stockholder during that period a written statement showing the amount of the allocation (or allocations) under section 216(b)(3)(B)(i) attributable to such tenant-stockholder's dwelling unit (or units) for that period. Any cooperative housing corporation making the election shall do so in accordance with paragraph (a) (2) and (3) of this section and shall identify in the statement described in paragraph (a)(3) of this section whether the election is for real estate taxes or interest or both.

(v) *Special rules for making the election with respect to the simplified dollar-value LIFO method.* The election under Act section 802 (Code section 474) may be made only if the taxpayer files with the taxpayer's income tax return for the taxable year as of the close of which the method is first to be used a statement of the taxpayer's election to use the simplified dollar-value LIFO inventory method. The statement shall be on Form 970 pursuant to the instructions to the form and to the requirements of the regulations under section 474, or in such other manner as may be acceptable to the Commissioner.

(vi) *Special rules for making election to have section 453C not apply to obligations arising from sales of timeshares and unimproved residential lots to individuals.* The election under Act section 811(a) (Code section 453C(e)(4)) to have section 453C not apply to obligations arising from sales of timeshares and unimproved residential lots to individuals may be made with respect to any obligation, or with respect to a class of such obligations. In the case of an election made with respect to a class of obligations, such election shall describe the class of obligations with such specificity as to make the class readily identifiable.

(vii) *Special rules for making certain finance leasing transitional rule elections.* The election relating to finance leases under Act section 1801(a)(1) (Code section 168(i) as in effect before October 22, 1986) shall be made by the lessor under a lease agreement subject to the finance lease rules of section 168(i) of the Code, as in effect before October 22, 1986, by noting

this election in the books and records relating to the lease agreement within 12 months after February 5, 1987.

(viii) *Special rules for making the election relating to the date leased property is treated as originally placed in service.* The election under Act section 1809(e)(2) (Code section 48(b)(2)) must be made jointly by the lessee and the lessor. The election is made jointly when both the lessee and the lessor make the election in accordance with paragraphs (a)(2) and (a)(3)(i) of this section. In addition to the other information required to be provided under paragraph (a)(3)(i) of this section, the statement described therein shall include a copy of the lease agreement and shall be signed by both the lessee and the lessor.

(ix) *Special rules for making the election to be treated as a resident alien.* The election under Act section 1810(l)(4) (Code section 7701(b)) to be treated as a resident under Code section 7701(b) shall be made by an alien individual by attaching a statement to the individual's income tax return (Form 1040), for the taxable year for which the election is to be in effect (the election year). The alien individual may not make this election until such time as he has satisfied the substantial presence test of Code section 7701(b)(1)(A)(ii) for the year following the election year. If an alien individual has not satisfied the substantial presence test for the year following the election year as of the due date (without regard to extensions) of the tax return for the election year, the alien individual may request an extension of time for filing the return until after he has satisfied such test, provided that he pays with his extension application the amount of tax he expects to owe for the election year, computed as if he were a non-resident alien throughout the election year. The statement shall include the name and address of the alien individual and contain a signed declaration that the election is being made. It must specify—

(A) That the alien individual was not a resident in the year immediately preceding the election year;

(B) That the alien individual is a resident in the year immediately following the election year under the substantial presence test and the individual's number of days of presence in the United States during such year;

(C) The date or dates of the alien individual's 31 consecutive day period of presence and continuous presence in the United States during the election year; and

(D) The date or dates of absence from the United States during the election

year that are deemed to be days of presence.

(x) *Special rules for making the election with respect to the treatment of the exercise of certain nonqualified stock options.* The election under Act section 1879(p)(1) (Code section 83(c)(3)) is made by filing on Form 1040X a claim for credit or refund of the overpayment of tax resulting from the election. In order to satisfy the requirements of § 301.6402-2(b)(1) (relating to grounds set forth in claim), the claim for credit or refund must set forth—

(A) The date on which the option was granted;

(B) The name of the corporation which granted the option;

(C) The date on which the stock was transferred pursuant to the exercise of the option;

(D) The fair market value of such stock on December 4, 1973;

(E) The fair market value on July 1, 1974 of the stock received upon the reorganization of the corporation which granted the option; and

(F) The date on which the taxpayer sold substantially all of the stock received in such reorganization. The taxpayer shall file a single claim for credit or refund of the entire overpayment of tax resulting from the election under Act section 1879(p)(1).

(4) *Revocation—(i) Irrevocable elections.* The elections described in this section under Act sections 201(a) [Code sections 168(b)(5), 168(f)(1), 168(g)(7), and 168(h)(6)(F)(ii)], 203(a)(1)(B), 252(a) [Code sections 42(f)(1), 42(g)(1), 42(i)(2), and 42(j)(5)], 411(b)(1) [Code section 263(i)], 411(b)(2)(A) [Code section 616(d)(2)(A)], 501(a) [Code section 469(j)(9)], 801(d)(2), 905(c), 1301(b) [Code sections 141(b)(9), 142(d)(1), 142(d)(4)(B), 143(k)(9)(D)(iii), 145(d), and 147(b)(4)(A)], 1431(a) [Code section 2652(a)(3)], 1704(b), 1802(a) [Code section 168(j) as in effect before October 22, 1986], 1804(e)(4), 1879(p)(1) [Code section 83(c)(3)], and 1882(C) [Code section 3121(w)(2)] are irrevocable.

(ii) *Elections revocable with the consent of the Commissioner.* The elections described in this section under Act sections 204(e), 243(a), 243(b), 243(a)(b), 411(b)(2)(B) [Code section 617(h)(2)(A)], 614(b) [Code section 1059(c)(4)], 621(a) [Code section 382(l)(5)(H)], 644(d) [Code section 216(b)(3)], 646, 651 [Code section 4982(e)(4)(B)], 701(a) [Code section 56(f)(3)(B)], 801(a) [Code section 448(d)(4)], 802 [Code section 474], 803(a) [Code section 263A(d)(3)], 806(e)(2)(C) [and the election described in H.R. Rep. No. 99-841 at II-320], 811(a) [Code sections 453C(b)(2)(B) (i) and 453C(e)(4)], 901(a) [Code sections

585(c)(3)(B)(ii) and 585(c)(4)], 905(a) [Code section 165(l)(1)], 1801(a) [Code section 168(i) as in effect before October 22, 1986], 1807(a)(7) [Code section 468B], 1809(e)(2) [Code section 48(b)(2)], and 1810(l)(4) [Code section 7701(b)] are revocable only with the consent of the Commissioner.

(iii) *Freely revocable elections.* The elections described in this section under Act sections 311(d)(2) and 1431(a) [Code section 2632(b)(3)] are freely revocable.

(b) *Elections with respect to the low-income housing credit.* The elections under Act section 252 (a) [Code sections 42(f)(1), 42(g)(1), 42(i)(2), and 42(j)(5)] must be made for the taxable year in which the project is placed in service and shall be made in the certification required to be filed pursuant to section 42(l)(1).

(c) *Election to have the rules of section 263A (relating to capitalization and inclusion in inventory costs of certain expenses) not apply to any plant or animal produced in any farming business conducted by the electing taxpayer—(1) In general.* This paragraph applies to the election under Act section 803(a) [Code section 263A(d)(3)] to have the rules of section 263A (relating to capitalization and inclusion in inventory costs of certain expenses) not apply to any plant or animal produced in any farming business conducted by the electing taxpayer. The election is available to taxpayers engaged in the business of farming, including producers of agricultural crops, livestock, nursery stock, sod, trees bearing fruit, nuts or other crops, and ornamental trees (for purposes of section 263A, an evergreen tree that is more than 6 years old at the time it is severed from the roots shall not be treated as an ornamental tree). The election is not available to a corporation, partnership, or tax shelter that is required to use the accrual method of accounting under section 447 or section 448(a)(3), or farming syndicates (as defined in section 464(c)), or with respect to the planting, cultivation, maintenance or development of pistachio trees. In addition, the election does not apply with respect to costs incurred for the planting, cultivation, maintenance or development of any citrus or almond grove incurred during the 4-taxable-year period beginning with the taxable year in which such grove was planted. If a citrus or almond grove is planted in more than one taxable year, the portion of the grove planted in one taxable year is treated as a separate grove for this purpose.

(2) *Time and manner of making the election.* Unless consent is obtained

from the Commissioner, the election may only be made for the taxpayer's first taxable year that begins after December 31, 1986, and during which the taxpayer engages in a farming business. The election shall be made on the Schedule E, F or other schedule required to be attached to the income tax return for the first taxable year for which the election is effective. In the case of a partnership or S corporation, the election must be made at the partner or shareholder level.

(3) *Election treated as if made if certain requirements satisfied.* A taxpayer eligible to make the election under section 263A(d)(3) shall be treated as having made the election if such taxpayer reports income and expense in accordance with the rules under the election on a timely filed income tax return.

(4) *Revocation.* Once the election is made, it is revocable only with the consent of the Commissioner.

(5) *Special rules for treatment of expenses.* If the election is made, the plant or animal produced is treated as section 1245 property and gain is recaptured (treated as ordinary income) in the amount of deductions which, but for the election, would have been required to be capitalized with respect to the plant or animal. If the taxpayer or a related person makes the election, a non-accelerated method of depreciation (as defined in section 168(g)(2)) shall be applied to all property used predominantly in any farming business of the taxpayer or related person and placed in service in any taxable year during which the election is in effect. For purposes of this election, related party means: (i) the members of the taxpayer's family (defined for this purpose to include the spouse of the taxpayer and any of this or her children who have not reached the age of 18 as of the last day of the taxable year); (ii) any corporation (including an S corporation) 50 percent or more of the value of which is owned directly or indirectly (through the application of section 318) by the taxpayer or members of the taxpayer's family; (iii) any corporation that is a member of the same controlled group (within the meaning of section 1563) as the taxpayer; and (iv) any partnership if 50 percent or more of the value of the interests in such partnership is owned directly or indirectly (through the application of section 318) by the taxpayer or members of the taxpayer's family.

(d) *Election with respect to the treatment of net income for the short taxable year resulting from a required change in accounting period.* This paragraph applies to the election under

section 806(e)(2)(C) of the Act. Net income for the short taxable year resulting from a required change in accounting period under the provisions of section 806 of the Act which is to be included ratably in the partners' and S corporation shareholders' income for the first four taxable years (including the short taxable year) beginning after December 31, 1986, or included entirely in income for the short taxable year at the election of the partner or shareholder, shall be taken into account in accordance with section 702 (with respect to partners) and section 1366 (with respect to S corporation shareholders).

(e) *Election with respect to reducing partnership or S corporation income for the short taxable year resulting from a required change in accounting period under section 806 of the Act by an unamortized adjustment amount existing as of October 22, 1986.*—(1) *In general.* This paragraph applies to the election described in H.R. Rep. No. 99-841 at II-320.

(2) *Partnerships or S corporations that make the election to reduce income for the short taxable year by an unamortized adjustment amount existing as of October 22, 1986.* Where a partnership or S corporation elects to reduce its income for the short taxable year required under the provisions of section 806 of the Act by the unamortized adjustment amount existing as of October 22, 1986, in accordance with paragraph (a) of this section, the income for the short taxable year (reduced by the unamortized adjustment amount) may then be subject to the election, under section 806(e)(2)(C) of the Act, by partners and S corporation shareholders to include all the net income for the short taxable year entirely in income for the partners' or shareholders' taxable year with or within which the short taxable year ends.

(3) *Partnership or S corporations that do not make the election to reduce income for the short taxable year by an unamortized adjustment amount existing as of October 22, 1986.* Where a partnership or S corporation does not elect to reduce its income for the short taxable year created by the provisions of section 806 of the Act by the unamortized adjustment amount existing as of October 22, 1986, as provided in paragraph (a) of this section, the short taxable year required under the provisions of section 806 of the Act shall be considered one taxable year for purposes of amortizing the adjustment amount under the requirements of Rev. Proc. 72-51, 1972-2 C.B. 832, or Rev. Proc. 83-25, 1983-1 C.B. 689. The net

income of the partnership or S corporation after reduction by the adjustment amount for the short taxable year may then be subject to the election under section 806(e)(2)(C) of the Act by partners or S corporation shareholders to include all the net income for the short taxable year entirely in income for the partners' or shareholders' taxable year with or within which the short taxable year of the partnership or S corporation ends.

(f) *Election with respect to the treatment of certain losses in insolvent financial institutions.*—(1) *In general.* This paragraph applies to the election under Act section 905(a) (Code section 165(l)(1)). If—

(i) As of the close of the taxable year, it can reasonably be estimated that there is a loss on a deposit of a qualified individual (as defined in section 165(l)(2)) in a qualified financial institution (as defined in section 165(l)(3)), and

(ii) Such loss is on account of the bankruptcy or insolvency of such institution,

then the qualified individual may elect to treat the entire amount so estimated for that taxable year (disregarding any amount treated as a casualty loss under section 165(c)(3) in a previous taxable year) as a loss § 5h.5(f)(1) described in section 165(c)(3) and incurred during the taxable year. The election shall apply to all losses of the qualified individual on deposits in the institution with respect to which an election is made, and section 166 (relating to bad debts) shall not apply to any loss with respect to which an election is made.

(2) *Time and manner of making the election.* The election may be made by claiming such loss on the tax return for any taxable year in which a reasonable estimate of such loss can be made. If the qualified individual does not claim such loss on the tax return for that taxable year, the qualified individual may not subsequently amend the tax return for that taxable year to claim such loss for that taxable year. However, for a tax return filed with respect to a taxable year beginning after December 31, 1982, but before January 1, 1986, the qualified individual may subsequently (before the expiration of the period prescribed for filing a claim for credit or refund) amend the tax return for that taxable year to claim such loss for that taxable year.

(3) *Revocability of the election.* This election may be revoked only with the consent of the Commissioner.

(g) *Elections with respect to certain bonds.* The elections under Act section 1301(b) (Code sections 141(b)(9), 142(d)(1), 142(d)(4)(B), 143(k)(9)(D)(iii),

145(d), and 147(b)(4)(A)) must be made in the § 5h.5 (g) bond indenture or a related document (as defined in § 1.103-13(b)(8)) on or before the date of issue. With respect to obligations issued on or before March 9, 1987 these elections must be made on or before March 9, 1987 and need not be made in the bond indenture or a related document, but must be made in writing and retained as part of the issuer's books and records.

(h) *Revocation of the election for exemption from social security taxes by certain clergy*—(1) *In general.* This paragraph applies to the election under Act section 1704(b) to revoke an election under section 1402(e)(1) of the Code by a duly ordained, commissioned, or licensed minister of a church, a member of a religious order (other than a member of a religious order who has taken a vow of poverty as a member of such order), or a Christian Science practitioner. Only elections which are effective for the taxable year containing October 22, 1986 may be revoked under this paragraph.

(2) *Time for revoking the election.* The election shall be revoked by filing Form 2031 before the date on which the individual becomes entitled to benefits under sections 202(a) or 223 of the Social Security Act (without regard to sections 202(j)(1) or 223(b) of such Act), and not later than the due date of the Federal income tax return (including any extension thereof) for the individual's first taxable year beginning after October 22, 1986.

(3) *Manner of revoking the election.* To revoke an election under section 1402(a)(1), the individual shall file Form 2031 in accordance with the instructions accompanying that form. The revocation shall be made effective, as designated by the individual on the form, either with respect to the individual's first taxable year beginning after October 22, 1986.

(4) *Special rules for payment of self-employment taxes with respect to certain taxable years ending on or after October 22, 1986*—(i) *Elections filed after the due date of the Federal income tax return.* In Form 2031 is filed on or after the due date of the Federal income tax return (including any extension thereof) for the individual's first taxable year ending on or after October 22, 1986, and the election made therein is effective with respect to that taxable year, Form 2031 shall be accompanied by an amended Federal income tax return for such taxable year together with payment in full of an amount equal to the total of the taxes that would have been imposed by section 1401 of the Code with respect to all of the individual's income derived in that

taxable year which would have constituted net earnings from self-employment for purposes of chapter 2 of subtitle A of the Code (notwithstanding paragraph (4) or (5) of section 1402(c)) but for the exemption under section 1402(e)(1).

(ii) *Elections filed before the due date of the Federal income tax return.* If Form 2031 is filed before the due date of the Federal income tax return (including any extension thereof) for the individual's first taxable year ending on or after October 22, 1986, and the election is effective with respect to that taxable year, payment in full of an amount equal to the total of the taxes that would have been imposed by section 1401 of the Code with respect to all of the individual's income derived in that taxable year which would have constituted net earnings from self-employment for purposes of chapter 2 of the subtitle A of the Code (notwithstanding paragraph (4) or (5) of section 1402(c)) but for the exemption under section 1402(e)(1) shall be made:

(A) In the case of Forms 2031 that are filed on or before the date on which the individual's Federal income tax return for such first taxable year is filed, with the individual's Federal income tax return for such taxable year; and

(B) In the case of Forms 2031 that are filed after the date on which the individual's Federal income tax return for such first taxable year is filed, with an amended Federal income tax return for that taxable year filed on or before the due date for the individual's Federal income tax return (including any extension thereof) for such taxable year.

(iii) *Interest on amounts paid after the due date of the Federal income tax return.* If any amount of tax imposed by section 1401 for an individual's taxable year with respect to which an election under this paragraph (h) is effective is paid after the due date of the individual's Federal income tax return (without regard to extensions) for such taxable year, interest will be assessed on such tax from the due date of such return (without regard to extensions) to the date on which such tax is paid.

(5) *Revocability of the revocation of the election.* Once having filed Form 2031, the individual may not thereafter file an application for an exemption under section 1402(e)(1).

(6) *Effective date of this provision.* This provision shall apply with respect to remuneration received in the taxable years for which the individual designates the revocation to be effective, as described in paragraph (h)(3) of this section, and with respect to monthly insurance benefits payable under title II of the Social Security Act

on the basis of the wages and self-employment income of any individual for months in or after the calendar year in which such individual's application for revocation is effective (and lump-sum death payments payable under such title on the basis of such wages and self-employment income in the case of deaths occurring in or after such calendar year).

(i) *Revocation of the election for exemption from social security taxes by certain churches on qualified church-controlled organizations*—(1) *In general.* This paragraph applies to the election under Act section 1882 (Code section 3121 (w)(2)) to revoke an election under section 3121(w) by a church or qualified church-controlled organization (as defined in section 3121(w)(3)).

(2) *Time and manner of revoking the election.* The revocation described in this paragraph (i) shall be made by filing a Form 941 on or before the due date for filing Form 941 (without regard to extensions) for the first quarter for which the revocation is to be effective, accompanied by payment in full of the taxes that would be due for that quarter had there been no election under section 3121(w). See paragraph (i)(4) of this section for the effective date of revocation made under this paragraph (i).

(3) *Revocability of the revocation of the election.* Once an election under section 3121(w) is revoked under this paragraph (i), a new election under section 3121(w) may not be made.

(4) *Effective date of this paragraph.* A revocation made under this paragraph (i) shall be effective for the quarter of the calendar year covered by the Form 941 on which the revocation is made in accordance with paragraph (i)(2) of this section and all subsequent quarters. However, no revocation shall be effective prior to January 1, 1987 unless such electing church or church-controlled organization had withheld and paid over all employment taxes due, as if such election had never been in effect, during the period from the effective date of the election being revoked through December 31, 1986.

(j) *Additional information required.* Later regulations or revenue procedures issued under provisions of the Code or Act covered by this section may require the furnishing of information in addition to that which was furnished with the statement of election described in this section. In such event, the later regulations or revenue procedures will provide guidance with respect to the furnishing of such additional information. (26 U.S.C. 7805).

PART 602—[AMENDED]

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

Authority: 28 U.S.C. 7805.

§ 602.10 [Amended]

Par. 4. Section 602.10(c) is amended by inserting in the appropriate place in the table "§ 5h.5 . . . 1545-0082".

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractical 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.

Lawrence B. Gibbs,

Commissioner of Internal Revenue.

Approved: January 13, 1987.

O. Donaldson Chapoton,

Acting Assistant Secretary of the Treasury.

[FR Doc. 87-2219 Filed 2-4-87; 8:45 am]

BILLING CODE 4830-01-M

Nevertheless, pursuant to the requirements of the Regulatory Flexibility Act, 5 U.S.C. 601-612, it is hereby stated that the order will not have "a significant economic impact on a substantial number of small entities."

List of Subjects in 28 CFR Part 16

Administrative practice and procedure, Courts, Freedom of information, Privacy, Sunshine Act.

Pursuant to the authority vested in the Attorney General by 5 U.S.C. 552a and delegated to me by Attorney General Order No. 793-78, the Department amends 28 CFR Part 16 by adding § 16.77 as set forth below.

Dated: January 8, 1987.

Harry H. Flickinger,

Acting Assistant Attorney General for Administration.

PART 16—[AMENDED]

1. The authority for Part 16 continues to read as follows:

Authority: 28 U.S.C. 509, 510; 5 U.S.C. 301, 552, 552a; 31 U.S.C. 483a unless otherwise noted.

2. It is proposed to amend 28 CFR Part 16 by adding § 16.77 to read as follows:

§ 16.77 Exemption of United States Trustee Program System—limited access.

(a) The following system of records is exempt from 5 U.S.C. 552a (c) (3) and (4); (d); (e) (1), (2) and (3), (e)(4) (G) and (H), (e) (5) and (8); (f) and (g):

(1) United States Trustee Program Case Referral System, JUSTICE/UST-004.

These exemptions apply to the extent that information in this system is subject to exemption pursuant to 5 U.S.C. 552a(j)(2) and (k)(2).

(b) Exemptions from the particular subsections are justified for the following reasons:

(1) From subsection (c)(3) because the release of the disclosure accounting would permit the subject of an investigation to obtain valuable information concerning the nature of that investigation. This would permit record subjects to impede the investigation, e.g., destroy evidence, intimidate potential witnesses, or flee the area to avoid inquiries or apprehension by law enforcement personnel.

(2) From subsection (c)(4) since an exemption being claimed for subsection (d) makes this subsection inapplicable.

(3) From subsection (d) because access to the records contained in this system might compromise ongoing investigations, reveal confidential informants, or constitute unwarranted invasions of the personal privacy of

third parties who are involved in a certain investigation. Amendment of the records would interfere with ongoing criminal law enforcement proceedings and impose an impossible administrative burden by requiring criminal investigations to be continuously reinvestigated.

(4) From subsections (e)(1) and (e)(5) because in the course of law enforcement investigations, information may occasionally be obtained or introduced the accuracy of which is unclear or which is not strictly relevant or necessary to a specific investigation. In the interest of effective law enforcement, it is appropriate to retain all information that may aid in establishing patterns of criminal activity. Moreover, it would impede the specific investigative process if it were necessary to assure the relevance, accuracy, timeliness, and completeness of all information obtained.

(5) From subsection (e)(2) because in a criminal investigation the requirement that information be collected to the greatest extent possible from the subject individual would present a serious impediment to law enforcement because the subject of the investigation would be placed on notice as to the existence of the investigation and would therefore be able to avoid detection or apprehension, to influence witnesses improperly, to destroy evidence, or to fabricate testimony.

(6) From subsection (e)(3) because the requirement that individuals supplying information be provided with a form stating the requirements of subsection (e)(3) would constitute a serious impediment to law enforcement in that it would compromise the existence of a confidential investigation or reveal the identity of witnesses or confidential informants.

(7) From subsections (e)(4) (G) and (H) because this system of records is exempt from the access provisions of subsection (d) pursuant to subsections (j) and (k).

(8) From subsection (e)(8) because the individual notice requirement of this subsection could present a serious impediment to law enforcement in that this could interfere with the U.S. Attorney's ability to issue subpoenas.

(9) From subsections (f) and (g) because this system has been exempted from the access provisions of subsection (d).

[FR Doc. 87-2307 Filed 2-4-87; 8:45 am]

BILLING CODE 4410-01-M

DEPARTMENT OF JUSTICE**28 CFR Part 16**

[AAG/A Order No. 1-87]

Exemption of Records Systems Under the Privacy Act

AGENCY: Department of Justice.

ACTION: Final rule.

SUMMARY: The Department of Justice is exemption a Privacy Act system of records from subsection (c)(3) and (4); (d); (e) (1), (2) and (3), (e)(4) (G) and (H), (e) (5) and (8); (f) and (g) of the Privacy Act, 5 U.S.C. 552a. This system is the "United States Trustee Program Case Referral System, JUSTICE/UST-004." Records contained in this system relate to official Federal investigations and matters of law enforcement. The exemptions are needed to protect ongoing investigations, as well as the privacy of third parties and the identities of confidential sources involved in such investigations.

EFFECTIVE DATE: February 5, 1987.

FOR FURTHER INFORMATION CONTACT:

J. Michael Clark, (202) 272-6474.

SUPPLEMENTARY INFORMATION:

A proposed rule with invitation to comment was published in the Federal Register on September 5, 1986 (51 FR 31781). The public was given 30 days to comment.

This order relates to individuals rather than small business entities.

DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 906

Approval of Amendments to Colorado Permanent Regulatory Program

AGENCY: Office of Surface Mining Reclamation and Enforcement (OSMRE), Interior.

ACTION: Final rule.

SUMMARY: The Director is announcing the approval of several proposed program amendments to the Colorado permanent regulatory program (hereinafter referred to as the Colorado program) under the Surface Mining Control and Reclamation Act of 1977 (SMCRA). The amendments consist of regulation changes and a policy statement addressing the program deficiencies set forth at 30 CFR 906.16 (b) through (h) in an earlier rulemaking.

EFFECTIVE DATE: February 5, 1987.

FOR FURTHER INFORMATION CONTACT:

Mr. Robert H. Hagen, Director, Albuquerque Field Office, Office of Surface Mining Reclamation and Enforcement, 219 Central Avenue NW., Albuquerque, New Mexico; Telephone: (505) 766-1406.

SUPPLEMENTARY INFORMATION:**I. Background on the Colorado Program**

Information regarding the general background on the Colorado program, including the Secretary's findings, the disposition of comments and a detailed explanation of the conditions of approval, can be found in the December 15, 1980 *Federal Register* (45 FR 82173-82214). Subsequent actions concerning the conditions of approval and program amendments are identified at 30 CFR 906.15 and 906.16.

II. Submission of Amendments

By letter dated August 18, 1986 (Administrative Record No. CO-294), Colorado submitted a proposed amendment consisting of various regulations modifications and a policy statement designed to address the program deficiencies identified in an earlier amendment (51 FR 4485-4497, February 5, 1986) and codified at 30 CFR 906.16 (b) through (h). The Director announced receipt of these materials in the October 9, 1986 *Federal Register* (51 FR 36231-36233) and invited public comment on their substantive adequacy.

III. Director's Findings

Set forth below, pursuant to SMRCA and the Federal regulations at 30 CFR

732.15 and 732.17, are the Director's findings concerning the proposed amendments submitted by Colorado. The letter in the heading of each finding refers to the paragraph of 30 CFR 906.16 containing the requirement which Colorado is addressing.

1. Required Amendment (b)

For the reasons set forth in Finding 1(d) of the February 5, 1986 *Federal Register* notice (51 FR 4486), the Director required that, by February 5, 1985, Colorado submit revisions to 2 CCR 407-2, 2.02.2(2)(g) or otherwise propose to amend its program to require that the notice filed by any person intending to conduct coal exploration involving the removal of 250 or fewer tons of coal include a complete description of the methods of exploration to be used and the practices that will be followed to reclaim the area following completion of exploration, and to clarify that specifying the maximum number of holes to be drilled will not fully satisfy this requirement.

The amendment submitted by Colorado on August 18, 1986 revises State rule 2.02.2(2)(g) to require that all coal exploration notices include a narrative description of the methods to be used to conduct coal exploration and reclamation. Therefore, the Director finds that the revised State rule is no less effective than the corresponding Federal regulations at 30 CFR 772.11(b)(5).

2. Required Amendment (c)

For the reasons set forth in Finding 1(f) of the February 5, 1986 *Federal Register* notice (51 FR 4486), the Director required that, by February 5, 1987, Colorado submit a revised form of 2 CCF 407-2, 4.21.4(1) replacing the cross reference to 2.05.6(2)(b) with one to 2.05.6(2)(a)(iii), or otherwise propose to amend the coal exploration provisions of its program to protect critical habitats of endangered or threatened species and habitats of unusually high value for fish, wildlife or related environmental values.

The amendment submitted by Colorado on August 18, 1986 replaces the cross reference to 2.05.6(2)(b) in 4.21.4(1) with one to 2.05.6(2)(b)(iii). Therefore, the Director finds that revised State rule 4.21.4(1) contains habitat protection requirements no less effective than those set forth in the Federal regulations at 30 CFR 815.15(a).

3. Required Amendment (d)

For the reasons set forth in Finding 3(a) of the February 5, 1986 *Federal Register* notice (51 FR 4487), the Director required that, by February 5, 1987, Colorado submit revisions to 2 CCR 407-

2, 4.06.1(2) or otherwise propose to amend its program to provide that topsoil storage practices other than stockpiling may be used only when (1) stockpiling would be detrimental to the quantity or quality of the stored materials, (2) all stored materials are moved to an approved site within the permit area, (3) the alternative practice would not permanently diminish the capability of the soil of the host site, and (4) the alternative practice would maintain the stored materials in a condition more suitable for future redistribution than would stockpiling.

The amendment submitted by Colorado on August 18, 1986 revises State rule 4.06.1(2) to require that the permittee demonstrate that a proposed alternative to stockpiling will provide more, rather than equal or more as in the previous version, protection for the topsoil. In addition, Colorado has proposed a policy statement in the form of a handbook memorandum entitled "Alternative to Topsoil Stockpiles", which requires that the Division consider the following factors when evaluating a proposed alternative practice: (1) Whether stockpiling would be detrimental to the quantity or quality of the topsoil, (2) whether the alternative practice would permanently diminish the capability of the host site, and (3) whether the alternative practice would maintain the topsoil in a condition more suitable for future distribution than would stockpiling. With respect to the remaining requirement of 39 CFR 906.16(d) that all stored materials be placed on an approved site within the permit area, Colorado rule 1.04(89) provides that all areas affected by surface coal mining reclamation operations must be included within the permit area. In addition, the policy statement requires that any proposed alternative practices be approved in writing by the Division. Therefore, the Director finds that revised State rule 4.06.1(2) and the accompanying handbook memorandum are no less effective than the requirements of the Federal regulations at 30 CFR 816.22(c)(3) and 817.22(c)(3).

4. Required Amendment (e)

For the reasons set forth in Finding 3(c) of the February 5, 1987 *Federal Register* (51 FR 4487), the Director required that, by February 5, 1987, Colorado submit revisions to 2 CCR 407-2, 4.06.2(2)(a) or otherwise propose to amend its program to establish definitive criteria governing the granting of topsoil removal variances, criteria which must be no less effective than those contained in the Federal

regulations at 30 CFR 816.22(a)(3) and 817.22(a)(3).

As originally submitted, the Colorado rules provided that areas which might qualify for a variance included, but were not limited to, light traffic areas where vegetation or soil stability would not be destroyed, areas where topsoil removal would result in needless damage to soil characteristics, and areas of construction of small structures such as power poles, signs or fences. As revised in the August 18, 1986 submission, Colorado now limits the variance to the specific situations listed above, as do the Federal rules at 30 CFR 816.22(a)(3) and 817.22(a)(3). Therefore, the Director finds that Colorado rule 4.06.2(2)(a), as revised, is no less effective than the corresponding Federal rules.

5. Required Amendment (f)

For the reasons set forth in Finding 3(d) of the February 5, 1987 Federal Register notice (51 FR 4487), the Director required that, by February 5, 1987, Colorado submit revisions to 2 CCR 407-2, 4.06.1(4)(a)(iii) or otherwise propose to amend its program to require that, before the State approves topsoil substitutes or supplements, the operator demonstrate that the proposed final soil medium would be the best available within the permit area to support the vegetation.

The amendment submitted by Colorado on August 18, 1986, revises State rule 4.06.2(4)(a) to provide that the Division may approve the use of topsoil substitutes or supplements only if the resulting soil medium is, among other things, the best available in the permit area to support revegetation. Therefore, the Director finds that revised Colorado rule 4.06.2(4)(a) is no less effective than the corresponding Federal regulations at 30 CFR 816.22(b) and 817.22(b).

6. Required Amendment (g)

For the reasons set forth in Finding 9(i) of the February 5, 1986 Federal Register (51 FR 4491), the Director required that, by February 5, 1987, Colorado submit revisions to 2 CCR 407-2, 2.10.1(1) or otherwise propose to amend its program to require that all areas upon which roads or support facilities, other than isolated monitoring stations involving little or no surface disturbance, are to be sited be mapped at a scale of 1:6,000 or larger.

The amendment submitted by Colorado on August 18, 1986, revises State rule 2.10.1(1) to require that all roads and support facilities within the permit area be shown on a large scale (1:6,000 or larger) map. Therefore, the Director finds that revised Colorado rule 2.10.1(1) is no less effective than the

corresponding Federal rule at 30 CFR 777.14(a).

7. Required Amendment (h)

For the reasons set forth in Finding 10(b) of the February 5, 1987 Federal Register notice (51 FR 4491-4492), the Director required that, by February 5, 1987, Colorado submit revisions to 2 CCR 407-2, 2.04.12(1) or otherwise propose to amend its program to require that prime farmland investigations be conducted on all lands upon which roads or support facilities are to be sited.

The amendment submitted by Colorado on August 18, 1986 revises State rule 2.04.12(1) to require that prime farmland investigations be conducted on all lands within the proposed permit area, or in the case of underground mining, only those areas proposed to be disturbed by surface operations or facilities. Colorado has proposed this language to eliminate the need for prime farmland investigations on areas overlying the underground workings of a mine where the surface is not disturbed. The State definition of "permit area" includes such areas whereas the Federal rules do not. In his February 5, 1986 rulemaking, the Director was concerned that, because of Colorado's interpretation of the term "disturbed area", investigations might not be made on all areas where certain roads and support facilities were to be sited. However, since Colorado has revised its topsoil rules at 4.06.2(2)(a) to require topsoil salvage wherever mining-related activities would otherwise adversely affect soil characteristics, such areas now would be considered potential disturbed areas under the State interpretation of that term and hence would be investigated for the presence of prime farmland. Therefore, the Director finds that Colorado rule 2.04.12(1), as revised, is no less effective than the corresponding Federal rule at 30 CFR 785.17(b)(1), which requires prime farmland reconnaissance surveys of all proposed permit areas.

IV. Public Comments

The Director solicited public comments on the proposed amendments in the October 9, 1986 Federal Register (51 FR 36231-36233). The comment period closed on November 10, 1986, without receipt of any comments. Since no one either requested an opportunity to present testimony at a hearing or expressed an interest in a public hearing, the public hearing scheduled for November 3, 1986, was not held.

Pursuant to section 503(b) of SMCRA and 30 CFR 732.17(h)(10)(i), the Director also solicited comments from various

Federal agencies. All agencies either declined comment or concurred in the amendments. However, the U.S. Forest Service noted that it must also review and approve all applications for permits or permit revisions where it is the surface land managing agency. In response, the Director notes that the cooperative agreement (30 CFR 906.30) governing mining on Federal lands in Colorado contains extensive provisions requiring consultation with the Federal land managing agency; it also requires that all necessary approvals be obtained.

V. Director's Decision

Based on the findings set forth above, the Director is approving the proposed amendments submitted by Colorado on August 18, 1986, and is removing the required amendments specified in 30 CFR 906.16 (b) through (h). The Federal rules at 30 CFR Part 906 are being amended to implement this decision. This final rule is being made effective immediately to expedite the State program amendment process and to encourage States to conform their programs with SMCRA without undue delay. Consistency of State and Federal standards is required by SMCRA.

VI. Procedural Matters

1. Compliance with the National Environmental Policy Act

The Secretary has determined that, pursuant to section 702(d) of SMCRA, 30 U.S.C. 1292(d), no environmental impact statement need be prepared on this rulemaking.

2. Executive Order No. 12291 and the Regulatory Flexibility Act

On August 28, 1981, the Office of Management and Budget (OMB) granted OSMRE an exemption from sections 3, 4, 7 and 8 of Executive Order 12291 for actions directly related to approval or conditional approval of State regulatory programs. Therefore, this action is exempt from preparation of a Regulatory Impact Analysis and regulatory review by OMB. The Department of the Interior has determined that this rule will not have a significant economic effect on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). This rule will not impose any new requirements; rather, it will ensure that existing requirements established by SMCRA and the Federal rules will be met by the State.

3. Paperwork Reduction Act

This rule does not contain information collection requirements which require

approval by the Office of Management and Budget under 44 U.S.C. 3507.

List of Subjects in 30 CFR Part 906

Coal mining, Intergovernmental relations, Surface mining, Underground mining.

Dated: January 30, 1987.

James W. Workman,

Deputy Director, Operations and Technical Services.

PART 906—COLORADO

30 CFR Part 906 is amended as follows:

1. The authority citation for Part 906 continues to read as follows:

Authority: Pub. L. 95-87, Surface Mining Control and Reclamation Act of 1977 (30 U.S.C. 1201 *et seq.*).

2. A new paragraph (h) is added to § 906.15 to read as follows:

§ 906.15 Approval of regulatory program amendments.

(h) The following amendments, as submitted on August 18, 1986, are approved effective February 5, 1987:

(1) Revisions to the following provisions of 2 CCR 407-2, the rules and regulations of the Colorado Mined Land Reclamation Board:

- 2.02.2(2) (g)
- 2.04.12(1)
- 2.10.1(1)
- 4.06.1(2)
- 4.06.2(2)(a)
- 4.06.2(4)(a)
- 4.21.4(1)

(2) The Handbook Memorandum entitled "Alternative to Topsoil Stockpiles", which interprets State rule 4.06.1(2).

§ 906.16 [Removed]

3. Section 906.16 is removed in its entirety.

[FR Doc. 87-2411 Filed 2-4-87; 8:45 am]

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DEPARTMENT OF DEFENSE

Office of the Secretary

32 CFR Part 166

Defense Contracting; Reporting Procedures on Defense Related Employment

AGENCY: Office of the Secretary of Defense.

ACTION: Amendment of final rule.

SUMMARY: This amendment to the rule is the fiscal year 1986 update of the section

listing DoD contractors receiving contract awards of \$10 million or more. The amendment is published to comply with the provisions of 10 U.S.C. 2397.

EFFECTIVE DATE: September 30, 1986.

FOR FURTHER INFORMATION CONTACT:

Mr. J.R. Sungenis, Director for Information Operations and Reports, Washington Headquarters Services, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302. Telephone (202) 746-0334.

SUPPLEMENTARY INFORMATION: In FR Doc. 70-15846 appearing in the *Federal Register* on November 25, 1970 (35 FR 18040), the Office of the Secretary of Defense published a final rule establishing criteria, prescribing procedures, and assigning responsibilities for monitoring contracting within the Department of Defense. Subsequently, fiscal years 1971 (36 FR 18464) through 1985 (50 FR 52443) which constitute the list of DoD contractors receiving contract awards for \$10 million or more, were updated.

List of Subjects in 32 CFR Part 166

Armed Forces, conflict of interests, government employees, government procurement, reporting and recordkeeping requirements.

PART 166—[AMENDED]

Accordingly, 32 CFR Part 166 is amended as follows:

1. The authority citation for part 166 is revised to read as follows:

Authority: 10 U.S.C. 2397.

2. Section 166.11 is revised to read as follows:

§ 166.11 Department of Defense contractors receiving contract awards of \$10 million or more.

Fiscal year 1986:

3D/International, Inc.
AAI Corp.
ACS Construction Co. of Miss.
ALM, Inc.
ALS Corp.
AT&T Information Systems
AT&T Technologies, Inc.
A/S Kongsberg Vaapenfabrikk
Aar Brooks & Perkins Corp.
Abbott Products, Inc.
Abex Corp.
Accudyne Corp.
Ace Industries, Inc.
Action Manufacturing Co.
Actus Corp/Escon, Inc., JV
Actus Corp.
Acurex Corp.
Addco Industries, Inc.
Advanced Computer Communications
Advanced Technology, Inc.
Aero Corp.
Aerodyne Investment Castings
Aerojet-General Corp.

Aeroquip Corp.
Aerospace Corp., The
Agip Deutschland
Agip Petroli Spa
Airspace Technology Corp.
Aksarben Foods
Alabama Power Co.
Alamo Technology, Inc.
Alascom, Inc.
Alexander, H.B. & Son, Inc.
Algernon Blair, Inc.
All-Bann Enterprises, Inc.
Allen, J.F. Co.
Allied Corp. Prestolite
Allied Corp.
Allis-Chalmers Corp.
Alpha Industries, Inc.
Altama Delta Corp.
AM General Corp.
Amerada Hess Corp.
American Airlines, Inc.
American Cyanamid Co., Inc.
American Development Corp.
American Electronic Laboratories, Inc.
American Export
American Express Company
American Fuel Cell
American Management Systems
American President Lines, Ltd.
American Puff Corp.
American Satellite Co.
American Systems Corp.
American Telephone & Telegraph Co.
American Trans Air, Inc.
Amertex Enterprises, Inc.
Ametek, Inc.
Amex Systems, Inc.
Amoco Corp.
Ampex Corp.
Amron Corp.
Amstar Technical Products Co.
Analysis & Technology, Inc.
Analytic Sciences Corp., The
Analytical Systems Engineering
Analytics Inc.
Andersen, Arthur & Co.
Anker Kolen Maatschappij BV
Annuss GmbH Co.
Apex Oil Co.
Applied Companies, Inc.
Applied Research, Inc.
Applied Technology Associates
Arcwel Corp.
Ardox Corp.
Argosystems, Inc.
Arinc Research Corp.
Arkla, Inc.
Arral Industries, Inc.
Arrow Air, Inc.
Asco Falcon II Shipping Co.
Ashland Oil, Inc.
Asis Oil Co., Ltd.
Associated Aerospace
Astrocom Electronics, Inc.
Astronautics Corp. of America
Atacs Corp.
Atkins, Claude E. Enterprises
Atlantic Marine, Inc.
Atlantic Research Corp.
Atlantic Richfield Co.
Atlas Processing Co.
Auburn Electric, Inc.
Aul Instruments, Inc.
Austin Co. The
Autek Systems Corp.