(ii) Under paragraph (b)(4)(i)(A) of this section, a change in the terms of a contract that alters the amount or timing of an item payable by the policyholder or the insurance company is a material change in the contract. Thus, B's coverage is treated as coverage under a contract issued on June 15, 2000, and, accordingly, the contract must meet the requirements of section 7702B(b) and any regulations issued thereunder in order to be a qualified long-term care insurance contract.

Example 4. (i) C, an individual, is the policyholder under a long-term care insurance contract purchased in 1994. At that time and through December 31, 1996, the contract met the long-term care insurance requirements of the State in which the contract was situsued. In 1996, the policy was amended to add a provision requiring the policyholder to be offered the right to increase dollar limits for inflation every three years (without the policyholder being required to pass a physical or satisfy any other underwriting requirements). During 2002, C elects to increase the amount of insurance coverage (with a resulting premium increase) pursuant to the inflation protection provision.

(ii) Under paragraph (b)(4)(ii)(A) of this section, an increase in the amount of insurance coverage at the election of the policyholder (without the insurance company's consent and without underwriting or other limitations on the policyholder's rights) pursuant to a pre-1997 inflation protection provision does not constitute a material change in the contract. Thus, C's contract continues to be a pre-1997 long-term care insurance contract that is treated as a qualified long-term care insurance contract.

Michael P. Dolan,

Deputy Commissioner of Internal Revenue.

[FR Doc. 97–33986 Filed 12–31–97; 8:45 am]

BILLING CODE 4830–01–U

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–115795–97]

RIN 1545–AV39

General Rules for Making and Maintaining Qualified Electing Fund Elections

AGENCY: Internal Revenue Service (IRS), Treasury

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

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations that provide guidance to a passive foreign investment company (PFIC) shareholder that makes the election under section 1295 (section 1295 election) to treat the PFIC as a qualified electing fund (QEF). The temporary regulations also provide guidance for shareholders that wish to make a section 1295 election that will apply on a retroactive basis (retroactive election). The temporary regulations also include a rule concerning the taxation under section 1291 of an exempt organization that is a shareholder of a PFIC that is not a pedigreed QEF. This rule was originally proposed in 1992. The text of the temporary regulations also serves as the text of these proposed regulations. In addition, this document proposes amendments to proposed regulation § 1.1296–4(e), concerning the treatment of interbank deposits as loans for purposes of the exception to passive income characterization of income derived in the active conduct of a banking business. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by April 2, 1998. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for April 16, 1998, must be received by March 26, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–115795–97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–115795–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_____regs/comments.html. The public hearing will be held in Room 3313, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Gayle Novig, (202) 622–3840; concerning submissions and the hearing, Evangelista Lee, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by March 3, 1998. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in proposed regulation §§ 1.1295–1(f), 1.1295–1(g), 1.1295–3(c), and 1.1295–3(g). The information required in § 1.1295–1 (f) and (g) will notify the Internal Revenue Service that certain shareholders have made the section 1295 election, and will enable the Internal Revenue Service to determine if a shareholder is satisfying the election and annual reporting requirements and is reporting income as required under section 1293.

The information required in proposed regulation § 1.1295–3(c) will notify the IRS that certain shareholders of foreign corporations have filed a Protective Statement to preserve their ability to make a retroactive section 1295 election, and that those shareholders have extended the periods of limitations for their taxable years to which the Protective Statement will apply. The information will enable the IRS to verify that the shareholders filing the Protective Statement had the requisite reasonable belief at the time they filed the statement. The information required in proposed regulation § 1.1295–3(g) will notify the IRS that a shareholder has made the retroactive election and, in the case of a shareholder that filed a Protective Statement, that the shareholder's waiver of the periods of

limitations will terminate within three years of making the election. The information will enable the Service to verify that the requirements for making a retroactive election have been satisfied.

The collection of information and responses to these collections of information are mandatory. The likely respondents are individuals, businesses, and other for-profit organizations.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Estimated total annual reporting/recordkeeping burden: 623 hours.

The estimated annual burden per respondent varies from 15 minutes to three hours, depending on individual circumstances, with an estimated average of 29 minutes.

Estimated number of respondents: 1,290.

Estimated annual frequency of responses: Annually or one time only.

Background

Sections 1291, 1293, 1295, and 1297

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) relating to sections 1291, 1293, 1295, and 1297. The temporary regulations contain rules concerning the taxation of exempt organizations under section 1291, elections under section 1295 to treat passive foreign investment companies as qualified electing funds (QEFs), the calculation of net capital gain for purposes of section 1293, and the inclusion of the pro rata shares of the earnings and profits of QEFs held through pass through entities. The temporary regulations amend § 1.1297–3T, permitting in certain cases the application of the rules of section 1291(d)(2)(B) to an election made under section 1297(b)(1).

The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

Section 1296

On April 28, 1995, proposed regulations were published providing guidance for the exceptions to passive income characterization of certain income derived by active foreign banks and foreign security dealers provided in section 1296 (b)(2)(A) and (b)(3), respectively. The proposed section 1296 regulations reflect comments received with respect to Notice 89–81, 1989–2 C.B. 399. That notice established tests for determining whether a foreign corporation qualified for the active foreign bank exception. The notice specifically stated that interbank deposits would not be treated as loans made in the ordinary course of a banking business.

After consideration of the comments received with respect to the Notice, the IRS and Treasury determined that interbank deposits were made and accepted in the ordinary course of a banking business, and therefore should be treated as such for purposes of section 1296(b)(2)(A). Accordingly, proposed regulation § 1.1296–4(d)(3) specifically includes interbank deposits with other deposits for purposes of determining whether the foreign corporation satisfies the deposit-taking requirements of § 1.1296–4(d). Also in response to comments, proposed regulation § 1.1296–4(e) is clarified to specifically provide that interbank deposits made with banks in the ordinary course of business constitute loans for purposes of § 1.1296–4. This clarification is favorable to taxpayers, and is proposed to be effective for taxable years beginning after December 31, 1994. It is also proposed that taxpayers may apply it to a taxable year beginning after December 31, 1986, provided it is consistently applied to that taxable year and all subsequent taxable years. The dates for applying proposed regulation § 1.1296–4(e) coincide with the dates for which § 1.1296–4 is proposed to be effective. See proposed regulation § 1.1296–4(k).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. It has been determined that an initial regulatory flexibility analysis is required for the collection of information in this notice of proposed rulemaking under 5 U.S.C. § 603. This analysis is set forth below under the heading ''Initial Regulatory Flexibility Analysis.''

Initial Regulatory Flexibility Analysis

This initial analysis is provided pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The major objective of the proposed regulations is to provide guidance to PFIC shareholders that wish to elect under section 1295 to treat their PFICs as QEFs, and provide guidance to those PFICs about the requirements imposed on them. The legal basis for these requirements is contained in sections 1293, 1294, and 1295. The IRS and Treasury are not aware of any federal rules that duplicate, overlap, or conflict with the proposed regulations.

The recordkeeping and reporting requirements of the proposed regulations enable the Internal Revenue Service to identify those taxpayers that are treating their PFICs as QEFs; to verify that those U.S. taxpayers are currently including their shares of QEF earnings in income, as required in section 1293 of the Internal Revenue Code; to be informed of those QEF shareholders that are not paying their section 1293 tax liability because they made the section 1294 election to defer the time for payment; to identify those shareholders of foreign corporations that are preserving their right to make a retroactive section 1295 election; to identify those shareholders making retroactive elections and verify that they are satisfying the requirements of a retroactive election; and, in the case of shareholders that have filed Protective Statements, the dates by which the shareholders' extensions of periods of limitations will terminate.

These proposed regulations will affect those small entities that are PFICs, at least one shareholder of which makes the section 1295 election. The proposed regulations also will affect those small entities that are PFIC shareholders that make the section 1295 election. The IRS and Treasury believe that affected small entities generally will be small businesses, as local governments are not likely to invest in PFICs. Also, few, if any, affected small entities likely will be tax exempt organizations, because only a tax exempt entity that is taxable under subchapter F on dividends received from the PFIC generally would need to consider making the section 1295 election.

The collections of information in these proposed regulations would impact a small entity that is treated as a QEF principally by requiring the

entity to calculate annually its ordinary earnings and net capital gain according to federal income tax accounting principles, as required by section 1293, and report that information to its shareholders that are U.S. persons. With the enactment of section 1(h), the QEF also must calculate each type of long term capital gain that it derived and the applicable rates of tax for proper inclusion of the QEF's net capital gain by the QEF shareholders. Alternatively, the regulations permit the QEF to provide its shareholders with its books, records and other documents necessary for the shareholders to calculate the ordinary earnings and net capital gain amounts. This alternative will enable a small entity that is a QEF to avoid the burden of calculating its net capital gain by providing its shareholders with information with which the shareholders can make the calculations.

The economic impact of other collections of information contained in these proposed regulations would fall on a small entity that is a shareholder of a PFIC for which it has made the section 1295 election or that is a pass through entity to which an interest holder transferred stock subject to a section 1295 election. The economic impact would result primarily from the reporting and recordkeeping requirements pertaining to (1) the manner for making the section 1295 election and the annual election requirements; (2) the calculation by the shareholder (rather than the QEF) of the QEF's ordinary earnings and net capital gain according to federal income tax principles, and its pro rata shares thereof; (3) a request for consent to revoke a section 1295 election; (4) the preservation of the right to make a retroactive election under section 1295; (5) a request for consent to make a retroactive election; (6) making a retroactive election, including filing amended returns for the affected taxable years; and (7) providing interest holders with PFIC statements and other information received by an intermediary shareholder.

The proposed regulations reduce the burden under existing rules for making the section 1295 election for all taxpayers, including small businesses and other small entities. Unlike the current requirements provided in Notice 88–125, the proposed regulations only require electing shareholders to file Form 8621 to make the section 1295 election, thereby eliminating the shareholder election statement as well as the requirement to file a copy of the PFIC Annual Information Statement. The proposed regulations only require shareholders to retain the PFIC Annual Information Statement or the Annual Intermediary Statement received as well as a copy of their filings for each year to which the section 1295 election applies. In addition, the proposed regulations impose a lesser burden on small shareholders, typically individuals and small entities, to preserve their right to make a retroactive election and a lesser burden of making a retroactive election. A small entity that owns less than five percent of each class of stock of a foreign corporation and satisfies other requirements is not required to file a Protective Statement to preserve its right to make a retroactive election with respect to the foreign corporation. Similarly, a small entity potentially has fewer amended returns to file to make a retroactive election than a shareholder that filed a Protective Statement. These changes in election requirements are illustrative of IRS efforts to minimize burden, particularly with respect to small entities.

An estimate of the number of small entities that would be affected by these regulations is unavailable. In any event, the enactment in 1997 of the mark-to-market election for PFIC shareholders and the elimination of the overlap in certain cases of subpart F and the PFIC provisions, will reduce the number of small entities that would be affected by these regulations.

None of the significant alternatives considered in drafting these regulations would have significantly altered the economic impact of the collections of information on small entities. In considering the significant alternatives that would be permissible under the Code and would enable the IRS to ensure compliance with the Code, the IRS and Treasury concluded that the alternatives generally would impose equal or greater burdens.

Comments and Public Hearing

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

A public hearing has been scheduled for April 16, 1998, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue lobby more than 15 minutes before the hearing starts.

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

Persons that wish to present oral comments at the hearing must submit written comments by April 2, 1998, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by March 26, 1998.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of the proposed regulations are Gayle Novig and Judith Cavell Cohen, of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1291–1 is added to read as follows:

[The text of this proposed section is the same as the text of § 1.1291–1T published elsewhere in this issue of the **Federal Register**.]

Par. 3. Section 1.1293–1 is added to read as follows:

§ 1.1293–1 Current taxation of income from qualified electing funds.

[The text of this proposed section is the same as the text of § 1.1293–1T published elsewhere in this issue of the **Federal Register**.]

Par. 4. Section 1.1295–1 is added to read as follows:

§ 1.1295–1 Qualified electing funds.

[The text of this proposed section is the same as the text of § 1.1295–1T published elsewhere in this issue of the **Federal Register**.]

Par. 5. Section 1.1295–3 is added to read as follows:

§ 1.1295–3 Retroactive elections.

[The text of this proposed section is the same as the text of § 1.1295–3T published elsewhere in this issue of the **Federal Register**.]

Par. 6. In § 1.1297–3, paragraph (c) is added to read as follows:

§ 1.1297–3 Deemed sale election by a United States person that is a shareholder of a passive foreign investment company.

[The text of this proposed paragraph (c) is the same as the text of § 1.1297–3T(c) published elsewhere in this issue of the **Federal Register**.]

Par. 7 Section 1.1296–4(e) as proposed at 60 FR 20922 (April 28, 1995) is amended by adding a sentence at the end of the paragraph to read as follows:

§ 1.1296–4 Characterization of certain banking income of foreign banks as passive.

* * * * *

(e) *Lending activities test.* * * * An interbank deposit made in the ordinary course of a corporation's banking business will be treated as a loan for purposes of this section. For the effective date of this paragraph (e), see paragraph (k) of this section.

Michael P. Dolan,

Deputy Commissioner of Internal Revenue.

[FR Doc. 97–33984 Filed 12–31–97; 8:45 am]

BILLING CODE 4830–01–U

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–209476–82]

RIN 1545–AE41

Loans to Plan Participants

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document amends proposed Income Tax Regulations under section 72(p) of the Internal Revenue Code relating to loans made from a qualified employer plan to plan participants or beneficiaries. Section 72(p) was added by section 236 of the Tax Equity and Fiscal Responsibility Act of 1982, and amended by the Technical Corrections Act of 1982, the Deficit Reduction Act of 1984, the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988. These regulations provide guidance to the public with respect to section 72(p), and affect administrators of, participants in, and beneficiaries of qualified employer plans that permit participants or beneficiaries to receive loans from the plan (including loans from section 403(b) contracts and other contracts issued under qualified employer plans).

DATES: Written comments and requests for a public hearing must be received by April 2, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–209476–82), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–209476–82), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax__regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations Vernon S. Carter, (202) 622–6070; concerning submissions or requests to speak at the hearing, La Nita VanDyke, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Proposed Income Tax Regulations (26 CFR Part 1) under section 72 of the Internal Revenue Code of 1986 (Code). These amendments provide additional guidance concerning the tax treatment of loans that are deemed to be distributed under section 72(p).

Explanation of Provisions

Section 72(p)(1)(A) provides that a loan from a qualified employer plan (including a contract purchased under a qualified employer plan) to a participant or beneficiary is treated as received as a distribution from the plan for purposes of section 72 (a deemed distribution). Section 72(p)(1)(B) provides that an assignment or pledge of (or an agreement to assign or pledge) any portion of a participant's or beneficiary's interest in a qualified employer plan is treated as a loan from the plan.

Section 72(p)(2) provides that section 72(p)(1) does not apply to the extent certain conditions are satisfied. Specifically, under section 72(p)(2), a loan from a qualified employer plan to a participant or beneficiary is not treated as a distribution from the plan if the loan satisfies requirements relating to the term of the loan and the repayment schedule, and to the extent the loan satisfies certain limitations on the amount loaned.

Regulations were proposed in 1995 [1] with respect to many of the issues arising under section 72(p)(2). The preamble to the 1995 proposed regulations requested comments on whether further guidance should be provided on certain issues that were not addressed. Following publication of the 1995 proposed regulations, comments were received and a public hearing was held on June 28, 1996. One of the issues on which comments were requested and received was the effect of a deemed distribution on the tax treatment of subsequent distributions from a plan (such as whether a participant has tax basis as a result of a deemed distribution). After reviewing the written comments and comments made at the public hearing, these new proposed regulations address this issue.

These new proposed regulations provide that once a loan is deemed distributed under section 72(p), the interest that accrues thereafter on that loan is not included in income.[2] Further, because the loan amount is treated as distributed for purposes of section 72, neither the income that resulted from the deemed distribution nor the interest that accrues thereafter increases the participant's investment in the contract (tax basis) for purposes of section 72.

For example, assume that, after a loan has been made from a defined contribution plan to a participant, a deemed distribution occurs as a result of failure to make timely loan repayments (e.g., the repayments were not to be made by payroll withholding [3]). The participant's total account then consists of non-loan assets and a receivable for the loan balance. At separation from employment, the participant's vested

[1] Proposed § 1.72(p)–1 (EE–106–82) was published in the **Federal Register** (60 FR 66233) on December 21, 1995.

[2] This treatment applies for purposes of determining the amount taxable under section 72 (including application of return of tax basis). However, as discussed below, the loan is still considered outstanding for purposes of determining the maximum amount of any subsequent loan to the participant under section 72(p)(2)(A). Even though interest continues to accrue on the outstanding loan and is taken into account for purposes of determining the maximum amount of any subsequent loan, this additional interest is not treated as an additional loan that results in a further deemed distribution for purposes of section 72(p).

[3] With respect to coverage under Title I of the Employee Retirement Income Security Act of 1974, the Department of Labor has advised the Service that an employer's tax-sheltered annuity program would not necessarily fail to satisfy the Department's regulation at 29 CFR 2510.3–2(f) merely because the employer permits employees to make repayments of loans made in connection with the tax-sheltered annuity program through payroll deductions as part of the employer's payroll deduction system, if the program operates within the limitations set by that regulation.