

§ 1.6045-1(g)(1) of this chapter) to the payor, but before the payor or broker treats the number or required certification as having been received under § 31.3406(e)-1(b).

(2) *Limitation.* For purposes of paragraph (a)(1) of this section, if a payor or broker withholds because the payor or broker has not received a taxpayer identification number or required certification and the payee subsequently provides a taxpayer identification number or a required certification to the payor, the payor or broker may not refund the amount to the payee.

(b) *Refunding amounts erroneously withheld—(1) Time and manner.* If a payor or broker withholds under section 3406 from a payee in error (including withholding more than the correct amount, as described in paragraph (a) of this section), the payor or broker may refund the amount erroneously withheld to the payee if the refund is made prior to the end of the calendar year and prior to the time the payor or broker furnishes a Form 1099 to the payee with respect to the payment for which the erroneous withholding occurred. If the amount of the erroneous withholding is refunded to the payee, the payor or broker must—

(i) Keep as part of its records a receipt showing the date and amount of refund and must provide a copy of the receipt to the payee (a canceled check or an entry in a statement is sufficient, provided that the check or statement contains a specific notation that it is a refund of tax erroneously withheld);

(ii) Not report on a Form 1099 as tax withheld any amount which the payor or broker has refunded to a payee; and

(iii) Not deposit the amount erroneously withheld if the payor or broker has not deposited the amount of the tax prior to the time that the refund is made to the payee.

(2) *Adjustment after the deposit of the tax.* For purposes of paragraph (b)(1) of this section, if the amount erroneously withheld has been deposited prior to the time that the refund is made to the payee, the payor or broker may adjust any subsequent deposit of the tax collected under chapter 24 of the Internal Revenue Code that the payor or broker is required to make in the amount of the tax that has been refunded to the payee.

PART 35a—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983

Par. 12. The authority citation for part 35a is amended by removing the entry

for 35a.3406-2 to read, in part, as follows:

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

§ 35a.3406-2 [Removed]

Par. 13. Section 35a.3406-2 is removed.

Par. 14. Section 35a.9999-0T is added to read as follows:

§ 35a.9999-0T Effective date (temporary).

In general, the provisions of §§ 35a.9999-1, 35a.9999-2, 35a.9999-3, 35a.9999-3A, 35a.9999-4T, and 35a.9999-5 are effective before January 1, 1997. The provisions of those sections remain effective after December 31, 1996, however, for purposes of § 301.6724-1(g) of this chapter, relating to due diligence safe harbor, and for international transactions, including transactions involving a foreign payee, a foreign payor, a foreign office of a U.S. bank or broker, or a payment from sources without the United States. See §§ 31.3406-0 through 31.3406(i)-1 of this chapter for rules that apply to other transactions after December 31, 1996.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 15. The authority for part 301 continues to read in part as follows:

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

Par. 16. Section 301.6109-1 is amended by:

1. Revising the third sentence in paragraph (a)(1).
2. Revising the first sentence in paragraph (h).

The revised sentences read as follows:

§ 301.6109-1 Identifying numbers.

(a) *In general—(1) Social security numbers and employer identification numbers.* * * * Social security numbers identify individual persons, while employer identification numbers identify corporations, partnerships, nonprofit associations, trusts, estates of decedents, and similar nonindividual persons. * * *

(h) *Effective date.* The provisions of this section are effective for information that must be furnished after April 15, 1974, except that the requirement that an estate obtain an Employer Identification Number applies on and after January 1, 1984. * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par 17. The authority for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 18. In § 602.101, paragraph (c) is amended by adding an entry to the table in numerical order to read as follows: “§ 31.3406(a)-1—§ 31.3406(i)-1...1545-0112”.

Dated: November 28, 1995.
Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved:
Cynthia G. Beerbower,
Deputy Assistant Secretary of the Treasury.
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26 CFR Parts 1 and 602

[TD 8643]

RIN 1545-AQ42

Distributions of Stock and Stock Rights

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations amending regulations under section 305(c) of the Internal Revenue Code relating to constructive distributions on preferred stock. The final regulations concern the treatment of stock redeemable at a premium by the issuer. The regulations generally treat a call premium as giving rise to a constructive distribution only if redemption pursuant to the call provision is more likely than not to occur. The final regulations also reflect 1990 amendments to section 305(c).

DATES: These regulations are effective December 20, 1995.

For dates of applicability of these regulations, see *Effective dates* under **SUPPLEMENTARY INFORMATION.**

FOR FURTHER INFORMATION CONTACT: Kirsten L. Simpson, (202) 622-7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1438. Responses to this collection of information are required to comply with the consistency requirements of the regulation.

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

estimated annual burden per respondent varies from 5 minutes to 15 minutes, depending on individual circumstances, with an estimated average of 10 minutes.

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

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

Background

On June 22, 1994, a notice of proposed rulemaking (CO-8-91), amending regulations under section 305(c) of the Internal Revenue Code relating to constructive distributions on preferred stock, was published in the Federal Register (59 FR 32160). No public hearing was requested and none was held.

Written comments responding to the notice were received. After consideration of all the comments, the regulations proposed by CO-8-91 are adopted as revised by this Treasury decision. The principal revisions are discussed below.

Explanation of Provisions

The primary focus of the final regulations is on preferred stock callable at a premium at the option of the issuer. The final regulations retain the approach of the proposed regulations and require constructive distribution treatment with respect to an issuer call only if, based on all of the facts and circumstances as of the issue date, redemption pursuant to the call right is more likely than not to occur.

Safe harbor rule. The proposed regulations provided a safe harbor, under which constructive distribution treatment does not result from an issuer call if the issuer and holder are unrelated, there are no arrangements that effectively require the issuer to redeem the stock, and exercise of the option to redeem would not reduce the yield of the stock. In response to comments, the final regulations make certain modifications to the safe harbor to clarify its scope.

Commentators suggested that the exclusion from the safe harbor where there are "arrangements that effectively require the issuer to redeem" is too narrow and will permit taxpayers who issue stock with "understandings" concerning redemption, whether or not legally enforceable, to qualify for the safe harbor. Commentators recommended safeguarding against abuse by changing the effectively requires redemption test to one that requires a lesser degree of probability. The IRS and Treasury intend that the safe harbor not be available where an issuer and a holder have an underlying understanding. Although the IRS and Treasury believe that the word "arrangement" is broad enough to include such understandings, in response to these comments, this prong of the safe harbor has been clarified.

To retain greater certainty for non-abusive transactions, however, the effectively requires redemption test has not been substantially modified. Instead, the final regulations safeguard against abuse by lowering the threshold for determining whether an issuer and a holder are related. The proposed regulations adopted a 50-percent threshold for determining whether an issuer and a holder are related. The final regulations lower this threshold to 20 percent. This threshold relates only to eligibility for the safe harbor, and not to the application of the general "more likely than not" test. When a holder's ownership interest exceeds this threshold, the IRS and Treasury believe it is appropriate to determine whether redemption is more likely than not to occur based on all of the facts and circumstances.

Commentators also suggested that the IRS and Treasury except preferred stock within the meaning of section 1504(a)(4) in determining whether the issuer and holder are related. The regulations do not adopt this suggestion. As noted above, the determination of whether the issuer and holder are related only governs eligibility for the safe harbor. The IRS and Treasury believe that when a holder's ownership interest in an issuer exceeds the threshold, even if all that the holder owns is preferred stock within the meaning of section 1504(a)(4), it is appropriate to determine whether redemption is more likely than not to occur based on all of the facts and circumstances.

In response to comments, the final regulations clarify that the "arrangements" that effectively require or are intended to compel the issuer to redeem the stock relate to the issuer call right, and not to a later mandatory redemption feature.

In testing whether a call right meets the yield prong of the safe harbor, the final regulations clarify that principles similar to the principles of section 1272(a) and the original issue discount regulations apply to determine whether exercise of the right to redeem would reduce the yield of the stock.

Miscellaneous. The final regulations expand the definition of issuer in certain circumstances. In particular, the regulations provide that if preferred stock may be acquired by a person other than the issuer (a third person), the term issuer includes such third person if the regulations would apply to the stock if the third person were the issuer, and acquisition of the stock by the third person would be treated as a redemption for federal income tax purposes (under section 304 or otherwise). In addition, if the issuer and the third person are members of the same affiliated group, the term issuer includes the third person if a principal purpose of the arrangement is to avoid the application of section 305 and the final regulations. Furthermore, an agreement or other arrangement for a person other than the issuer of the stock to acquire the stock may create a conversion transaction within the meaning of section 1258.

The final regulations provide rules for the treatment of mandatory redemption obligations and put options that are subject to contingencies. Generally, premiums on such stock are not subject to constructive distribution treatment if the contingency renders remote the likelihood of redemption. For example, where an issuer issues stock that is mandatorily redeemable in the event of an initial public offering, the regulations require evaluation of the likelihood of the occurrence of the initial public offering. The regulations provide, however, that a contingency does not include the possibility of default, insolvency, or similar circumstances, or that a redemption may be precluded by applicable law due to insufficient capital.

The preamble to the proposed regulations requested comments on the appropriate treatment of unpaid cumulative dividends. Because of the complexity of this issue, the final regulations do not provide rules for those dividends. The IRS and Treasury will continue to consider the issue, as well as other issues involving the implementation of the amendments to section 305(c) made by the Revenue Reconciliation Act of 1990. The IRS and Treasury continue to invite public comments on these issues.

EFFECTIVE DATES. The regulations apply to stock issued on or after December 20, 1995. Although the regulations do not apply to stock issued before December 20, 1995, the rules of sections 305(c) (1), (2), and (3) apply to stock described therein issued on or after October 10, 1990, except as provided in section 11322(b)(2) of the Revenue Reconciliation Act of 1990 (Pub. L. 101-508 Stat.). Moreover, except as provided in section 11322(b)(2) of the Revenue Reconciliation Act of 1990 (Pub. L. 101-508 Stat.), with respect to stock issued on or after October 10, 1990, and issued before December 20, 1995, the economic accrual rule of section 305(c)(3) will apply to the entire call premium on stock that is not described in paragraph (b)(2) of this section if the premium is considered to be unreasonable under the principles of § 1.305-5(b) (as contained in the 26 CFR part 1 edition revised April 1, 1995). A call premium described in the preceding sentence will be accrued over the period of time during which the preferred stock cannot be called for redemption.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Kirsten L. Simpson of the Office of Assistant Chief Counsel (Corporate), IRS. However, other personnel of the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding the following entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * * Section 1.305-3 also issued under 26 U.S.C. 305. Section 1.305-5 also issued under 26 U.S.C. 305. Section 1.305-7 also issued under 26 U.S.C. 305. * * *

Par. 2. Section 1.305-3 is amended as follows: 1. In paragraph (e), remove the parentheses from the numbers in the headings for *Examples (1) through (15)*.

2. In paragraph (e), *Example 15* is revised to read as follows:

§ 1.305-3 Disproportionate distributions.

* * * * *
(e) * * *

Example 15. (i) *Facts.* Corporation V is organized with two classes of stock, class A common and class B convertible preferred. The class B stock is issued for \$100 per share and is convertible at the holder's option into class A at a fixed ratio that is not subject to full adjustment in the event stock dividends or rights are distributed to the class A shareholders. The class B stock pays no dividends but it is mandatorily redeemable in 10 years for \$200. Under sections 305(c) and 305(b)(4), the entire redemption premium (i.e., the excess of the redemption price over the issue price) is deemed to be a distribution of preferred stock on preferred stock which is taxable as a distribution of property under section 301. This amount is considered to be distributed over the 10-year period under principles similar to the principles of section 1272(a). During the year, the corporation declares a dividend on the class A stock payable in additional shares of class A stock.

(ii) *Analysis.* The distribution on the class A stock is a distribution to which sections 305(b)(2) and 301 apply since it increases the proportionate interests of the class A shareholders in the assets and earnings and profits of the corporation and the class B shareholders have received property (i.e., the constructive distribution described above). If, however, the conversion ratio of the class B stock were subject to full adjustment to reflect the distribution of stock to class A shareholders, the distribution of stock dividends on the class A stock would not increase the proportionate interest of the class A shareholders in the assets and earnings and profits of the corporation and such distribution would not be a distribution to which section 301 applies.

(iii) *Effective date.* This *Example 15* applies to stock issued on or after December 20, 1995. For previously issued stock, see § 1.305-3(e) *Example (15)* (as contained in the 26 CFR part 1 edition revised April 1, 1995).

Par. 3. Section 1.305-5 is amended as follows:

1. Paragraph (b) is revised.
 2. In paragraph (d), remove the parentheses from the numbers in the headings for *Examples (1) through (9)*, redesignate *Examples 8* and *9* as *Examples 9* and *10*, respectively.
 3. In paragraph (d), *Examples 4, 5, and 7* are revised, and *Example 8* is added.
 4. Paragraph (e) is added.
- The revisions read as follows:

§ 1.305-5 Distributions on preferred stock.
* * * * *

(b) *Redemption premium—(1) In general.* If a corporation issues preferred stock that may be redeemed under the circumstances described in this paragraph (b) at a price higher than the issue price, the difference (the redemption premium) is treated under section 305(c) as a constructive distribution (or series of constructive distributions) of additional stock on preferred stock that is taken into account under principles similar to the principles of section 1272(a). However, constructive distribution treatment does not result under this paragraph (b) if the redemption premium does not exceed a de minimis amount, as determined under the principles of section 1273(a)(3). For purposes of this paragraph (b), preferred stock that may be acquired by a person other than the issuer (the third person) is deemed to be redeemable under the circumstances described in this paragraph (b), and references to the issuer include the third person, if—

- (i) This paragraph (b) would apply to the stock if the third person were the issuer; and
- (ii) Either—
 - (A) The acquisition of the stock by the third person would be treated as a redemption for federal income tax purposes (under section 304 or otherwise); or
 - (B) The third person and the issuer are members of the same affiliated group (having the meaning for this purpose given the term by section 1504(a), except that section 1504(b) shall not apply) and a principal purpose of the arrangement for the third person to acquire the stock is to avoid the application of section 305 and paragraph (b)(1) of this section.

(2) *Mandatory redemption or holder put.* Paragraph (b)(1) of this section applies to stock if the issuer is required to redeem the stock at a specified time or the holder has the option (whether or not currently exercisable) to require the issuer to redeem the stock. However, paragraph (b)(1) of this section will not

apply if the issuer's obligation to redeem or the holder's ability to require the issuer to redeem is subject to a contingency that is beyond the legal or practical control of either the holder or the holders as a group (or through a related party within the meaning of section 267(b) or 707(b)), and that, based on all of the facts and circumstances as of the issue date, renders remote the likelihood of redemption. For purposes of this paragraph, a contingency does not include the possibility of default, insolvency, or similar circumstances, or that a redemption may be precluded by applicable law which requires that the issuer have a particular level of capital, surplus, or similar items. A contingency also does not include an issuer's option to require earlier redemption of the stock. For rules applicable if stock may be redeemed at more than one time, see paragraph (b)(4) of this section.

(3) *Issuer call*—(i) *In general.* Paragraph (b)(1) of this section applies to stock by reason of the issuer's right to redeem the stock (even if the right is immediately exercisable), but only if, based on all of the facts and circumstances as of the issue date, redemption pursuant to that right is more likely than not to occur. However, even if redemption is more likely than not to occur, paragraph (b)(1) of this section does not apply if the redemption premium is solely in the nature of a penalty for premature redemption. A redemption premium is not a penalty for premature redemption unless it is a premium paid as a result of changes in economic or market conditions over which neither the issuer nor the holder has legal or practical control.

(ii) *Safe harbor.* For purposes of this paragraph (b)(3), redemption pursuant to an issuer's right to redeem is not treated as more likely than not to occur if—

(A) The issuer and the holder are not related within the meaning of section 267(b) or 707(b) (for purposes of applying sections 267(b) and 707(b) (including section 267(f)(1)), the phrase "20 percent" shall be substituted for the phrase "50 percent");

(B) There are no plans, arrangements, or agreements that effectively require or are intended to compel the issuer to redeem the stock (disregarding, for this purpose, a separate mandatory redemption obligation described in paragraph (b)(2) of this section); and

(C) Exercise of the right to redeem would not reduce the yield of the stock, as determined under principles similar to the principles of section 1272(a) and the regulations under sections 1271 through 1275.

(iii) *Effect of not satisfying safe harbor.* The fact that a redemption right is not described in paragraph (b)(3)(ii) of this section does not affect the determination of whether a redemption pursuant to the right to redeem is more likely than not to occur.

(4) *Coordination of multiple redemption provisions.* If stock may be redeemed at more than one time, the time and price at which redemption is most likely to occur must be determined based on all of the facts and circumstances as of the issue date. Any constructive distribution under paragraph (b)(1) of this section will result only with respect to the time and price identified in the preceding sentence. However, if redemption does not occur at that identified time, the amount of any additional premium payable on any later redemption date, to the extent not previously treated as distributed, is treated as a constructive distribution over the period from the missed call or put date to that later date, to the extent required under the principles of this paragraph (b).

(5) *Consistency.* The issuer's determination as to whether there is a constructive distribution under this paragraph (b) is binding on all holders of the stock, other than a holder that explicitly discloses that its determination as to whether there is a constructive distribution under this paragraph (b) differs from that of the issuer. Unless otherwise prescribed by the Commissioner, the disclosure must be made on a statement attached to the holder's timely filed federal income tax return for the taxable year that includes the date the holder acquired the stock. The issuer must provide the relevant information to the holder in a reasonable manner. For example, the issuer may provide the name or title and either the address or telephone number of a representative of the issuer who will make available to holders upon request the information required for holders to comply with this provision of this paragraph (b).

* * * * *
(d) * * *

Example 4—(i) *Facts.* Corporation X is a domestic corporation with only common stock outstanding. In connection with its acquisition of Corporation T, X issues 100 shares of its 4% preferred stock to the shareholders of T, who are unrelated to X both before and after the transaction. The issue price of the preferred stock is \$40 per share. Each share of preferred stock is convertible at the shareholder's election into three shares of X common stock. At the time the preferred stock is issued, the X common stock has a value of \$10 per share. The preferred stock does not provide for its

mandatory redemption or for redemption at the option of the holder. It is callable at the option of X at any time beginning three years from the date of issuance for \$100 per share. There are no other plans, arrangements, or agreements that effectively require or are intended to compel X to redeem the stock.

(ii) *Analysis.* The preferred stock is described in the safe harbor rule of paragraph (b)(3)(ii) of this section because X and the former shareholders of T are unrelated, there are no plans, arrangements, or agreements that effectively require or are intended to compel X to redeem the stock, and calling the stock for \$100 per share would not reduce the yield of the preferred stock. Therefore, the \$60 per share call premium is not treated as a constructive distribution to the shareholders of the preferred stock under paragraph (b) of this section.

Example 5—(i) *Facts*—(A) Corporation Y is a domestic corporation with only common stock outstanding. On January 1, 1996, Y issues 100 shares of its 10% preferred stock to a holder. The holder is unrelated to Y both before and after the stock issuance. The issue price of the preferred stock is \$100 per share. The preferred stock is—

(1) Callable at the option of Y on or before January 1, 2001, at a price of \$105 per share plus any accrued but unpaid dividends; and

(2) Mandatorily redeemable on January 1, 2006, at a price of \$100 per share plus any accrued but unpaid dividends.

(B) The preferred stock provides that if Y fails to exercise its option to call the preferred stock on or before January 1, 2001, the holder will be entitled to appoint a majority of Y's directors. Based on all of the facts and circumstances as of the issue date, Y is likely to have the legal and financial capacity to exercise its right to redeem. There are no other facts and circumstances as of the issue date that would affect whether Y will call the preferred stock on or before January 1, 2001.

(ii) *Analysis.* Under paragraph (b)(3)(i) of this section, paragraph (b)(1) of this section applies because, by virtue of the change of control provision and the absence of any contrary facts, it is more likely than not that Y will exercise its option to call the preferred stock on or before January 1, 2001. The safe harbor rule of paragraph (b)(3)(ii) of this section does not apply because the provision that failure to call will cause the holder to gain control of the corporation is a plan, arrangement, or agreement that effectively requires or is intended to compel Y to redeem the preferred stock. Under paragraph (b)(4) of this section, the constructive distribution occurs over the period ending on January 1, 2001. Redemption is most likely to occur on that date, because that is the date on which the corporation minimizes the rate of return to the holder while preventing the holder from gaining control. The de minimis exception of paragraph (b)(1) of this section does not apply because the \$5 per share difference between the redemption price and the issue price exceeds the amount determined under the principles of section 1273(a)(3) ($5 \times .0025 \times \$105 = \1.31). Accordingly, \$5 per share, the difference between the redemption price and the issue price, is treated as a constructive distribution

received by the holder on an economic accrual basis over the five-year period ending on January 1, 2001, under principles similar to the principles of section 1272(a). * * *

Example 7—(i) Facts—(A) Corporation Z is a domestic corporation with only common stock outstanding. On January 1, 1996, Z issues 100 shares of its 10% preferred stock to C, an individual unrelated to Z both before and after the stock issuance. The issue price of the preferred stock is \$100 per share. The preferred stock is—

(1) Not callable for a period of 5 years from the issue date;

(2) Callable at the option of Z on January 1, 2001, at a price of \$110 per share plus any accrued but unpaid dividends;

(3) Callable at the option of Z on July 1, 2002, at a price of \$120 per share plus any accrued but unpaid dividends; and

(4) Mandatorily redeemable on January 1, 2004, at a price of \$150 per share plus any accrued but unpaid dividends.

(B) There are no other plans, arrangements, or agreements between Z and C concerning redemption of the stock. Moreover, there are no other facts and circumstances as of the issue date that would affect whether Z will call the preferred stock on either January 1, 2001, or July 1, 2002.

(i) *Analysis.* This stock is described in paragraph (b)(2) of this section because it is mandatorily redeemable. It is also potentially described in paragraph (b)(3)(i) of this section because it is callable at the option of the issuer. The safe harbor rule of paragraph (b)(3)(ii) of this section does not apply to the option to call on January 1, 2001, because the call would reduce the yield of the stock when compared to the yield produced by the January 1, 2004, mandatory redemption feature. Moreover, absent any other facts indicating a contrary result, the fact that redemption on January 1, 2001, would produce the lowest yield indicates that redemption is most likely to occur on that date. Under paragraph (b)(4) of this section, paragraph (b)(1) of this section applies with respect to the issuer's right to call on January 1, 2001, because redemption is most likely to occur on January 1, 2001, for \$110 per share. The de minimis exception of paragraph (b)(1) of this section does not apply because the \$10 per share difference between the redemption price payable in 2001 and the issue price exceeds the amount determined under the principles of section 1273(a)(3) ($5 \times .0025 \times \$110 = \1.38). Accordingly, \$10 per share, the difference between the redemption price and the issue price, is treated as a constructive distribution received by the holder on an economic accrual basis over the five-year period ending January 1, 2001, under principles similar to the principles of section 1272(a).

(iii) *Coordination rules—*(A) If Z does not exercise its option to call the preferred stock on January 1, 2001, paragraph (b)(4) of this section provides that the principles of paragraph (b) of this section must be applied to determine if any remaining constructive

distribution occurs. Under paragraphs (b)(3)(i) and (b)(4) of this section, paragraph (b)(1) of this section applies because, absent any other facts indicating a contrary result, the fact that redemption on July 1, 2002, would produce a lower yield than the yield produced by the mandatory redemption feature indicates that redemption on that date is most likely to occur. The safe harbor rule of paragraph (b)(3)(ii) of this section does not apply to the option to call on July 1, 2002, because, as of January 1, 2001, a call by Z on July 1, 2002, for \$120 would reduce the yield of the stock. The de minimis exception of paragraph (b)(1) of this section does not apply because the \$10 per share difference between the redemption price and the issue price (revised as of the missed call date as provided by paragraph (b)(4) of this section) exceeds the amount determined under the principles of section 1273(a)(3) ($1 \times .0025 \times \$120 = \0.30). Accordingly, the \$10 per share of additional redemption premium that is payable on July 1, 2002, is treated as a constructive distribution received by the holder on an economic accrual basis over the period between January 1, 2001, and July 1, 2002, under principles similar to the principles of section 1272(a).

(B) If Z does not exercise its second option to call the preferred stock on July 1, 2002, then the \$30 additional redemption premium that is payable on January 1, 2004, is treated as a constructive distribution under paragraphs (b)(2) and (b)(1) of this section. The de minimis exception of paragraph (b)(1) of this section does not apply because the \$30 per share difference between the redemption price and the issue price (revised as of the second missed call date) exceeds the amount determined under the principles of section 1273(a)(3) ($1 \times .0025 \times \$150 = \0.38). The holder is treated as receiving the constructive distribution on an economic accrual basis over the period between July 1, 2002, and January 1, 2004, under principles similar to the principles of section 1272(a).

Example 8—(i) Facts. The facts are the same as in paragraph (i) of Example 7, except that, based on all of the facts and circumstances as of the issue date (including an expected lack of funds on the part of Z), it is unlikely that Z will exercise the right to redeem on either January 1, 2001, or July 1, 2002.

(ii) *Analysis.* The safe harbor rule of paragraph (b)(3)(ii) of this section does not apply to the option to call on either January 1, 2001, or July 1, 2002, because each call would reduce the yield of the stock. Under paragraph (b)(3)(i) of this section, neither option to call is more likely than not to occur, because, based on all of the facts and circumstances as of the issue date (including an expected lack of funds on the part of Z), it is not more likely than not that Z will exercise either option. However, the \$50 per share redemption premium that is payable on January 1, 2004, is treated as a constructive distribution under paragraphs (b) (1) and (2) of this section, regardless of whether Z is

anticipated to have sufficient funds to redeem on that date, because Z is required to redeem the stock on that date. The de minimis exception of paragraph (b)(1) of this section does not apply because the \$50 per share difference between the redemption price and the issue price exceeds the amount determined under the principles of section 1273(a)(3) ($8 \times .0025 \times \$150 = \3).

* * * * *

(e) *Effective date.* The rules of paragraph (b) of this section and *Examples 4, 5, 7, and 8* of paragraph (d) of this section apply to stock issued on or after December 20, 1995. For rules applicable to previously issued stock, see § 1.305-5 (b) and (d) *Examples (4), (5), and (7)* (as contained in the 26 CFR part 1 edition revised April 1, 1995). Although the rules of paragraph (b) of this section and the revised examples do not apply to stock issued before December 20, 1995, the rules of sections 305(c) (1), (2), and (3) apply to stock described therein issued on or after October 10, 1990, except as provided in section 11322(b)(2) of the Revenue Reconciliation Act of 1990 (Public Law 101-508 Stat.). Moreover, except as provided in section 11322(b)(2) of the Revenue Reconciliation Act of 1990 (Public Law 101-508 Stat.), with respect to stock issued on or after October 10, 1990, and issued before December 20, 1995, the economic accrual rule of section 305(c)(3) will apply to the entire call premium on stock that is not described in paragraph (b)(2) of this section if the premium is considered to be unreasonable under the principles of § 1.305-5(b) (as contained in the 26 CFR part 1 edition revised April 1, 1995). A call premium described in the preceding sentence will be accrued over the period of time during which the preferred stock cannot be called for redemption.

Par. 4. Section 1.305-7 is amended by revising the fourth sentence in the concluding text of paragraph (a) to read as follows:

§ 1.305-7 Certain transactions treated as distributions.

(a) * * *

* * * For example, where a redemption premium exists with respect to a class of preferred stock under the circumstances described in § 1.305-5(b) and the other requirements of this section are also met, the distribution will be deemed made with respect to such preferred stock, in stock of the same class. * * *

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

Par. 6. In § 602.101, paragraph (c) is amended in the table by adding the entry "1.305-5.....1545-1438" in numerical order.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: December 11, 1995.

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 95-30831 Filed 12-20-95; 8:45 am]

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26 CFR Parts 31 and 301

[TD 8636]

RIN 1545-AN57

Time for Furnishing Wage Statements on Termination of Employer's Operations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning the time for furnishing wage statements to employees and for filing wage statements with the Social Security Administration upon the termination of an employer's operations. These regulations will affect employers and their employees in the year the employer ceases to pay wages. These regulations are intended to improve the wage reconciliation process between the Social Security Administration and the IRS.

EFFECTIVE DATE: These regulations are effective January 1, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:T:R (EE-83-89), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:T:R (EE-83-89), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Jean M. Casey, (202) 622-6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 22, 1994, the Federal Register (59 FR 65982) published a notice of proposed rulemaking which required an employer to furnish Forms W-2 to employees and to file Forms W-2 and W-3 with the Social Security Administration (SSA) at the same time that the employer is required to file the final Form 941 with the IRS.

Written comments responding to the notice of proposed rulemaking were received. A public hearing was held on May 8, 1995, pursuant to a notice published in the Federal Register on March 24, 1995 (60 FR 15526). After consideration of the comments that were received in response to the notice of proposed rulemaking and at the hearing, the IRS and Treasury adopt the proposed regulations, as amended and revised by this Treasury decision.

Explanation of Revisions and Summary of Comments

Availability of Forms W-2

The regulations, as proposed, would have required an employer who ceases paying wages to furnish Form W-2 to employees and file Forms W-2 and W-3 with SSA on or before the date on which the final Form 941 is required to be filed with the IRS. Form 941 is generally due quarterly, on or before the last day of the first calendar month following the period for which it is made (i.e., April 30, July 31, October 31, and January 31). Consequently, if an employer ceased paying wages in the first quarter of the calendar year, the Forms 941, W-2 and W-3 would be due by April 30. Some commentators expressed concern that Forms W-2 and W-3 are not available in the first quarter of the calendar year. Commentators questioned whether using prior year Forms W-2 was an acceptable alternative if current year forms were unavailable.

Under the Internal Revenue Code and the existing regulations, an employee may request the Form W-2 at any time during the year if the employee is terminated and there is no reasonable expectation on the part of the employer or the employee of further employment during the calendar year. Therefore, Forms W-2 are available from the IRS,

either through the mail or at the district offices, in January of each year. Specifications for the private printing of substitute Forms W-2, however, are not always available during the first quarter of the calendar year. Thus, during this period, employers may be limited to using the Forms W-2 printed by the IRS. Neither prior year Forms W-2 nor the prior year specifications for the private printing of substitute Forms W-2 should be used for filing Forms W-2 on an expedited basis for the current year because such procedures could result in significant processing errors.

Availability of Magnetic Media Specifications

Commentators questioned whether magnetic media specifications would be available in the first quarter of the calendar year for employers who are required to file on an expedited basis under the proposed regulations. Regulation section 301.6011-2 and Notice 90-15, 1990-1 C.B. 326, generally require an employer to file Forms W-2 with SSA on magnetic media if the employer is required to file 250 or more Forms W-2 in a calendar year. Employers who do not meet the 250 return threshold may also file their Forms W-2 with SSA on magnetic media.

It is not certain that magnetic media specifications, which are issued by SSA, will be available in the first quarter of the calendar year for employers who are required to file on an expedited basis. The Commissioner has the authority to provide for reasonable extensions of time, upon written application, for an employer to furnish Forms W-2 to employees and file Forms W-2 and W-3 with SSA. To assure that filers need not shift from magnetic media to paper filings in order to comply with the expedited filing requirements, the final regulations affirm that the Commissioner may adopt automatic extension procedures where appropriate.

It is anticipated that the Commissioner will establish automatic extension procedures to the extent necessary to permit employers that terminate operations a reasonable period of time, after the issuance of specifications, to make their filings on magnetic media.

It is further anticipated that these procedures will include appropriate automatic extensions of time to file