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OFFICE OF GOVERNMENT ETHICS

5 CFR Part 2634

RIN 3209-AA06

Public Financial Disclosure, Conflicts of Interest, and Certificates of Divestiture for Executive Branch Officials

AGENCY: Office of Government Ethics (OGE).

ACTION: Final rule.

SUMMARY: The Office of Government Ethics is adopting as final, with certain amendments, interim rules issued in 1990 implementing a provision of the Ethics Reform Act of 1989, as amended, which provides for tax deferral in appropriate cases involving the sale of property to comply with conflict of interest requirements. The regulation sets forth OGE's procedure for issuing Certificates of Divestiture authorizing such sales, and defines the permitted property into which the proceeds from such sales must be reinvested. The amendments being made in this rulemaking document reflect certain technical amendments to the underlying statutory provision and some other changes based on OGE's experience under, as well as the comments received on, the interim regulation.

EFFECTIVE DATE: July 25, 1996.

FOR FURTHER INFORMATION CONTACT: Norman B. Smith, Office of Government Ethics, Suite 500, 1201 New York Avenue, NW., Washington, DC 20005-3917; telephone: 202-208-8000; FAX: 202-208-8037.

SUPPLEMENTARY INFORMATION:

A. Review of Statutory Change, Comment Letters and Rule Changes

The Office of Government Ethics published an interim regulation on April 18, 1990 at 55 FR 14407-14409 establishing procedures with respect to

the issuance of Certificates of Divestiture, which permit the nonrecognition of gain upon the disposition of property to comply with conflicts of interest requirements. That regulation is codified at subpart J of 5 CFR part 2634 of OGE's executive branch financial disclosure regulations. Section 1043 of the Internal Revenue Code of 1986, 26 U.S.C. 1043, was enacted as part of the Ethics Reform Act of 1989 (Public Law 101-194). Pursuant to section 1043, the subpart J regulation provides that OGE can issue a Certificate of Divestiture with respect to specific property, pursuant to the procedures specified, based upon a determination that such divestiture by an executive branch official (or spouse or minor/dependent child thereof) is reasonably necessary to comply with 18 U.S.C. 208, or any other Federal conflict of interest statute, regulation, rule or Executive order, or is requested by a congressional committee as a condition of confirmation, in the case of an "eligible person" as defined in the rule. The regulation also defines "permitted property" into which the proceeds from divestitures must be reinvested.

The Federal purpose reflected in section 1043 of the Internal Revenue Code and these rules is to minimize the burden of Government service resulting from gain on the sale of assets for which divestiture is reasonably necessary because of the conflict of interest laws, in order to attract and retain desirable personnel in the executive branch and to ensure the confidence of the public in the integrity of Government officials and the Government's decisional processes within a framework of procedural fairness achieved through consistent application of the mandatory procedure.

The Office of Government Ethics is now adopting the interim Certificate of Divestiture regulation as final, with a few revisions as discussed herein. First, one change reflects the inclusion of certain trustees as eligible persons as set forth in new paragraph (d) of § 2634.1002. The May 1990 Technical Corrections to the Ethics Reform Act of 1989 (Pub. L. 101-280) added a new subsection (b)(5) to section 1043 of the Internal Revenue Code of 1986, which expanded that section's definition of "eligible person" in subsection (b)(1) of section 1043 to include any trustee of a trust with respect to which a beneficial

interest in property or income is either held by, or attributable through a spouse or minor or dependent child by Federal ethics principles to, a Government official.

The legislative history of this provision evidences that the House Committee on Ways and Means did not intend through this amendment that the tax benefits of the section's nonrecognition mechanism would be generally available to beneficiaries of a trust other than those referred to in subsection (b)(1) (A) and (B) of section 1043 (that is the Government official and any spouse and minor and dependent children). The concern was that there may be additional parties who are beneficiaries of a trust who would obtain an unintended benefit.

It is understood that the committee's intent was that the Office of Government Ethics' authority to issue Certificates of Divestiture be restricted as follows. A certificate will not be issued unless the parties take those actions which, in the opinion of the OGE Director, are appropriate to exclude parties in addition to those referred to in subsection (b)(1) (A) and (B) of section 1043 from participation in the nonrecognition mechanism. Such measures may include, as permitted by applicable State trust and estate law, division of the trust into separate portfolios, special distributions, dissolution of the trust, or any other method deemed by the Director, in his sole discretion, to be feasible under the facts and circumstances to exclude additional parties from benefiting from the nonrecognition mechanism.

In view of the further analysis which must be undertaken by the Office of Government Ethics in the case of a Certificate of Divestiture request with respect to a trustee, it is now to be expressly required, in new paragraph (d) of § 2634.1002, that the case materials furnished to the Office of Government Ethics include a copy of the trust instrument, full details as to its current portfolio, and a memorandum analyzing all beneficial interests in principal and income. To the extent that there may be additional parties with beneficial interests, the Office of Government Ethics may consult with representatives of the Government official, trustee, and other concerned parties, as appropriate, in order to resolve the issues presented.

As a general premise, it must be emphasized that the section 1043 mechanism applies to capital assets (as defined by section 1221 of the Internal Revenue Code, 26 U.S.C. 1221) held by an eligible individual (as defined by section 1043(b)). Not all transactions or occurrences which result in the realization of gain by an eligible individual fall within the statutory scheme. Some transactions and occurrences simply do not fit the statutory requirements, others may present instances where certification would give an unfair or unintended benefit.

In this connection, the issues involved in requests for Certificates of Divestiture involving interests in pension, profit-sharing, and stock bonus plans are subject to considerable subtlety and complexity. With respect to such employee benefit plans, such an unfair and unintended benefit would occur upon certification of property held or received during one step of a sequence in avoidance of transferring an otherwise qualifying rollover distribution to an eligible retirement plan within 60 days. In other words, certificates may not be used to achieve a tax advantaged removal of employee benefit plan funds from the rules which normally pertain to such plans in cases where no capital gains tax would be imposed if those rules were followed.

Accordingly, in the absence of a demonstration that an interest in an employee benefit plan is not eligible for rollover treatment, a certificate will not be issued with respect to such an interest. Such a demonstration must satisfy the Office of Government Ethics that the plan administrator cannot make a qualifying distribution in the case of the eligible person to which the provisions of section 402(f) of the Internal Revenue Code, 26 U.S.C. 402(f), would apply and that the particular property interest proposed for certification falls within the statutory scheme of section 1043 of such Code.

The rules pertaining to these concerns are contained in new paragraph (e) of § 2634.1002 to guard against unfair and unintended benefits. The paragraph also specifies that a certificate will not be issued with respect to the exercise of stock options that will result in compensation income. Further, the paragraph states that a certificate will not be issued after the normally applicable three-month period for complying with an ethics agreement with respect to divestiture (or any extension of such period to which the Office of Government Ethics has concurred in writing), and that in order for a certificate to be granted, the parties

must also agree to divest all similar or related interests in property. The statement of materials to be submitted with a certificate request has been clarified to ensure that adequate information is received with respect to additional interests in the case of executive branch employees who do not normally file financial disclosure reports (see § 2634.1002(b)(1)(ii)(B)). Finally, a new provision has been added to specify that a certificate will not be issued as to property acquired under improper circumstances (see § 2634.1002(e)(6)).

The Office of Government Ethics received comments from three agencies on its April 1990 interim rules. Paragraph (b)(1)(v) of § 2634.1002 is being revised pursuant to the suggestion of one agency that the documentation required to substantiate the request of a congressional committee that specific property be divested conform to the types of materials more readily available in such circumstances. That provision has been expanded to include as appropriate documentation a letter to the committee containing a promise from the nominee to divest specified property in accordance with the committee's request or, alternatively, a transcript of congressional testimony containing such a commitment by the nominee pursuant to the committee's request. The agency also urged that paragraph (c)(2) of § 2634.1002 be expanded to include within the definition of eligible person the spouse and children of any officer or employee referred to in paragraph (c)(1) of that provision whose ownership of property is attributable to such officer or employee by a congressional committee. However, such an expansion of the scope of this provision would exceed the statutory coverage of Internal Revenue Code section 1043(b)(1)(B) and is, therefore, impermissible. On the other hand, it would seem that in most situations where this concern would arise divestiture would appear reasonably necessary to comply with Executive Order 12674 (as modified by E.O. 12731) on Principles of Ethical Conduct for Government Officers and Employees and regulations pursuant to such order, including 5 CFR part 2635 and any supplemental agency regulations. Accordingly, the appropriate statutory basis for the issuance of a Certificate of Divestiture would exist in the vast majority of situations which can be anticipated.

One agency observed that the concept of "investment fund" as defined for purposes of Internal Revenue Code section 1043 contrasts with that found in section 102(f)(8) of the Ethics in

Government Act, 5 U.S.C. appendix, section 102(f)(8). The concern was further expressed that a third concept of investment fund may exist under 18 U.S.C. 208 with respect to the consideration of waivers under subsection (b) of that provision. However, such types of distinctions are normally encountered in legislative materials. The definition which appears in § 2634.1003 of the Certificate of Divestiture regulation is in accordance with the statutory scheme of section 1043 of the Internal Revenue Code. In any forthcoming regulations, the Office of Government Ethics will continue to achieve such harmony and uniformity in ethics program rules as is permitted by applicable statutes and their legislative histories.

One agency criticized the regulations for not specifying the time by which a divestiture must occur after a Certificate of Divestiture has been issued, or the time by which a rollover must be completed. The agency stated further that an eligible person is not given any guidance as to how to associate the certificate with tax return material, and that he should not be required to use a certificate that has been issued to him.

First, while the availability of Certificates of Divestiture will be important to persons who receive them, the primary focus of the ethics program should be on the ethics agreement mechanism of subpart H of 5 CFR part 2634 (or a similarly structured agreement for any eligible nonreporting individual seeking a certificate). There should not be a request for a Certificate of Divestiture in cases in which there is not a binding ethics agreement to divest property pursuant to the procedures specified by subpart H (or under a similarly structured arrangement), normally within three months unless an extension is granted. Such an agreement should include a specification of the time by which divestiture is to occur. The time specified may be in terms of a formula such as "thirty days after the issuance of a Certificate of Divestiture by the Office of Government Ethics, but not later than _____". New paragraph (e)(4) of § 2634.1002 will now provide that, in the case of an agreement to implement a divestiture required by statute, regulation, rule, or executive order, the normal three-month period will be deemed to start no later than 10 days after such requirement becomes applicable. However, it must be realized that section 1043 is essentially a tax matter. Except for those specifics described as the scope of these regulations in paragraph (b) of § 2634.1001, which is being revised to take note of the 60-day period for

qualified rollovers and the types of permitted property into which such rollovers are to be made (United States obligations and diversified investment funds as defined in § 2634.1003) under the statute, 26 U.S.C. 1043 (a) and (b)(3), other aspects of the availability and use of section 1043 and the certificates issued pursuant to its mechanism are the responsibility of the Internal Revenue Service and beyond the authorities delegated to the Office of Government Ethics.

Finally, OGE is also clarifying a few passages in the rule, including adding an express statement (at § 2634.1002(b)(1)(i)) that a certificate cannot be issued for property which has already been divested, and is revising the authority citation for the entire part 2634 regulation to ensure inclusion once more of reference to 26 U.S.C. 1043, which was inadvertently omitted in the 1995 edition of the CFR.

B. Matters of Regulatory Procedure
Executive Order 12866

In promulgating this final rule issuance, the Office of Government Ethics adhered to the regulatory philosophy and the applicable principles of regulation set forth in section 1 of Executive Order 12866, Regulatory Planning and Review. This final rule has also been reviewed by the Office of Management and Budget under that Executive order.

Regulatory Flexibility Act

As Director of the Office of Government Ethics, I certify under the Regulatory Flexibility Act (5 U.S.C. chapter 6) that this final regulation will not have a significant economic impact on a substantial number of small entities because it only affects certain financial interests of executive branch employees and their immediate families.

Paperwork Reduction Act

The Paperwork Reduction Act (44 U.S.C. chapter 35) does not apply because this regulatory issuance does not contain any additional information collection requirements that require the approval of the Office of Management and Budget.

List of Subjects in 5 CFR Part 2634

Administrative practice and procedure, Certificates of divestiture, Conflict of interests, Financial disclosure, Government employees, Penalties, Privacy, Reporting and recordkeeping requirements, Trusts and trustees.

Approved: April 18, 1996.
Stephen D. Potts,
Director, Office of Government Ethics.

Accordingly, for the reasons set forth in the preamble, the Office of Government Ethics is adopting the interim regulation codified at subpart J of 5 CFR part 2634, published at 55 FR 14407- 14409 (April 18, 1990), as a final regulation with the following amendments:

PART 2634—[AMENDED]

1. The authority citation for part 2634 is revised to read as follows:

Authority: 5 U.S.C. App. (Ethics in Government Act of 1978); 26 U.S.C. 1043; E.O. 12674, 54 FR 15159, 3 CFR, 1989 Comp., p. 215, as modified by E.O. 12731, 55 FR 42547, 3 CFR, 1990 Comp., p. 306.

Subpart J—Certificates of Divestiture

2. Paragraph (b) of § 2634.1002 is amended by revising the second sentence and adding a new third sentence to read as follows:

§ 2634.1001 Nonrecognition for sales to comply with conflict of interest requirements; general considerations.

* * * * *

(b) *Scope.* * * * The rules of this subpart relate to the issuance of Certificates of Divestiture and the permitted property into which a reinvestment must be made during the 60-day period beginning on the date of such a sale in order for nonrecognition to be permitted. Such reinvestments are called rollovers, and are limited to obligations of the United States and diversified investment funds as defined in § 2634.1003. * * *

* * * * *

3. Section 2634.1002 is amended by revising paragraphs (b)(1)(i), (b)(1)(ii), (b)(1)(iv)(B), (b)(1)(v), and (c), and adding new paragraphs (d) and (e) to read as follows:

§ 2634.1002 Issuance of Certificates of Divestiture.

* * * * *

(b) *Procedural requirements—(1) Required submissions.* * * *

(i) A copy of a written request from the eligible person who is to divest the property (a Certificate of Divestiture cannot be issued for property which has already been divested) to the designated agency ethics official to pursue certification in the case of the property to be divested, which includes:

(A) A commitment to complete the divestiture on or before a specified date which is no later than the end of the three-month period referred to by § 2634.802(b) (or a similarly structured

agreement in any case to which paragraph (b)(1)(ii)(B) of this section applies), or any extension thereof granted, or concurred with in writing, by the Office of Government Ethics; and

(B) Full and complete information concerning the facts and circumstances relating to the acquisition of such property and its contemplated divestiture;

(ii) In the case of an individual referred to in paragraph (c)(1) of this section who:

(A) Is required by the rules of this part or this title, to file a financial disclosure report, a copy of the latest report which has been filed; or

(B) Is not required to file a report referred to in paragraph (b)(1)(ii)(A) of this section, a memorandum from such individual which discloses the information with respect to the specification of interests in property, income, liabilities, agreements and arrangements, and outside positions which are required to be disclosed on such a report;

* * * * *

(iv) * * *

(B) Analysis and opinion from such designated agency ethics official concerning the application of the rules of this part in the case of the proposed certification, including specification of the date on which the three-month period referred to by § 2634.802(b) (or a similarly structured agreement in any case to which paragraph (b)(1)(ii)(B) of this section applies), or any extension thereof granted, or concurred with in writing, by the Office of Government Ethics, will lapse; and

(v) In lieu of the materials described in paragraph (b)(1)(iv) of this section, in the case of the contemplated divestiture of specific property pursuant to the request of a congressional committee as a condition of confirmation, such materials shall include the written acknowledgement of the Chairman of such committee of such request, a letter to the committee containing a promise from the nominee to divest specified property in accordance with such request, or a transcript of congressional testimony containing such a commitment by the nominee pursuant to such request.

* * * * *

(c) *Eligible person.* For purposes of section 1043 and this subpart, the term "eligible person" includes:

(1) Any officer or employee of the executive branch of the Federal Government, except a person who is a special Government employee as defined in 18 U.S.C. 202;

(2) The spouse and any minor or dependent child of an individual

referred to in paragraph (c)(1) of this section whose ownership of property required to be divested is attributable to such person by 18 U.S.C. 208, or any other Federal conflict of interest statute, regulation, rule, or executive order; and

(3) Any trustee holding property in trust required to be divested in which:

(i) An individual referred to in paragraph (c)(1) of this section has a beneficial interest in principal or income; or

(ii) A spouse or any minor or dependent child of an individual referred to in paragraph (c)(2) of this section has a beneficial interest in principal or income which is attributable to a person referred to in paragraph (c)(1) of this section by 18 U.S.C. 208, or any other Federal conflict of interest statute, regulation, rule, or executive order.

(d) *Special rules in the case of a trustee who is an eligible person.* (1) Notwithstanding any other rule of this subpart, in the case of a trustee who is an eligible person pursuant to paragraph (c)(3) of this section, a Certificate of Divestiture will not be issued unless the parties take those actions which, in the opinion of the Director of the Office of Government Ethics, are appropriate to exclude parties in addition to those referred to in paragraph (c) (1) and (2) of this section from participation in the nonrecognition mechanism. Such measures may include, as permitted by applicable State trust and estate law, division of the trust into separate portfolios, special distributions, dissolution of the trust, or any other method deemed by the Director, in his sole discretion, to be feasible under the facts and circumstances to exclude additional parties from benefiting from the nonrecognition mechanism.

(2) In view of the further analysis which must be undertaken by the Office of Government Ethics in the case of a Certificate of Divestiture request with respect to a trustee, the required submissions in such a case shall include in addition to the materials described in paragraph (b)(1) of this section, a copy of the trust instrument, full details as to its current portfolio, and a memorandum analyzing all beneficial interests in principal and income. To the extent that there may be additional parties with beneficial interests, the staff of the Office of Government Ethics may consult with representatives of the Government official, trustee, and other concerned parties, as appropriate, in order to resolve the issues presented in light of the principles described in paragraph (d)(1) of this section.

(e) *Special rules in the case of employees; unfair and unintended*

benefits—(1) In general.

Notwithstanding any other rule of this subpart, a Certificate of Divestiture will not be issued in any case in which, in the opinion of the Director of the Office of Government Ethics, in his sole discretion, an unfair or unintended benefit would be conferred on an eligible person. Paragraphs (e)(2) through (g)(6) of this section give examples of the application of the general rule of this paragraph (e)(1).

(2) *Employee benefit plans.* With respect to interests in pension, profit-sharing, stock bonus and other employee benefit plans, such an unfair or unintended benefit would occur upon certification of property held or received during one step of a sequence in avoidance of transferring an otherwise qualifying rollover distribution to an eligible retirement plan within 60 days. In other words, Certificates of Divestiture may not be used to achieve a tax advantaged removal of employee benefit plan funds from the rules which normally pertain to such plans in cases where no capital gains tax would be imposed if those rules were followed. Accordingly, in the absence of a demonstration that an interest in an employee benefit plan is not eligible for rollover treatment, a certificate will not be issued with respect to such an interest. Such a demonstration must satisfy the Office of Government Ethics that the plan administrator cannot make a qualifying distribution in the case of the eligible person to which the provisions of section 402(f) of the Internal Revenue Code of 1986 would apply and that the particular property interest proposed for certification falls within the statutory scheme.

(3) *Certain property received as compensation for services.* Such an unfair and unintended benefit would occur upon certification of property received as compensation for services, the gain from which would otherwise be treated as earned income. For example, with respect to the contemplated exercise of a stock option granted by an employer, such an unfair and unintended benefit would occur upon certification if such exercise or the sale of the resultant stock would otherwise result in earned income to the employee.

(4) *Non timely divestitures.* With respect to any contemplated divestiture, such an unfair or unintended benefit would occur upon certification after the three-month period referred to by § 2634.802(b) (or a similarly structured agreement in any case to which paragraph (b)(1)(ii)(B) of this section applies) has lapsed, unless there is an

extension of time in a case of unusual hardship as determined pursuant to such section by the Office of Government Ethics or the designated agency ethics official (with the written concurrence of the Office of Government Ethics). In the case of such an agreement to implement a divestiture required by statute, regulation, rule, or executive order, such three-month period shall be deemed, for purposes of this subpart, to have started no later than 10 days after such requirement had become applicable.

(5) *Similar or related interests.* With respect to any contemplated divestiture, such an unfair or unintended benefit would occur unless all similar or related interests in property were also subject to a divestiture commitment.

(6) *Property acquired under improper circumstances.* With respect to any contemplated divestiture, such an unfair advantage or unintended benefit would occur if the property was acquired at a time when the holding of such property was prohibited by any law or regulation or under circumstances which otherwise would create the appearance of a conflict with the conscientious performance of governmental responsibilities.

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DEPARTMENT OF AGRICULTURE

Animal and Plant Health Inspection Service

7 CFR Part 301

[Docket No. 95-087-1]

Japanese Beetle; Domestic Quarantine and Regulations

AGENCY: Animal and Plant Health Inspection Service, USDA.

ACTION: Interim rule.

SUMMARY: We are amending the Japanese beetle quarantine and regulations to add Minnesota and Wisconsin to the list of quarantined States and to provide greater specificity about what actions must be taken to prevent the spread of Japanese beetle by aircraft from regulated airports. The actions specified by these amendments are necessary to prevent the spread of Japanese beetle into noninfested areas of the United States. We are also amending the regulations to allow carriers at regulated airports the option of performing some activities under a compliance agreement with the Animal and Plant Health Inspection Service,