

OMB clearance for petitions for an exemption under the Fur Act, even though it has received no such petitions over the past decade. A Notice soliciting public comments on extending these clearances through December 31, 1999, was recently published in the Federal Register. 61 FR 43764 (August 26, 1996).

The Commission's current proposal regarding cancellation of RN numbers, discussed in detail above, would not impose an additional "burden" on current and/or future holders of Registered Identification Numbers. This is because the Fur Rules at 16 CFR 301.26(b)(2) already require companies to notify the FTC about changes in business names, addresses, company type, etc. The current proposal merely adds the element of cancellation by the Commission if these requirements are not met. Neither the initial filing procedures nor the requirement to update the information are new and therefore, no additional "burden" is imposed.

More importantly, the underlying certification itself does not meet the definition of "information" contained in the PRA. In implementing the Paperwork Reduction Act of 1995, OMB attempted to clarify the exemption for "certifications" in Section 1320.3(h) (1)-(10) in both the Notice of Proposed Rulemaking, 60 FR 30438, 30439 (June 8, 1995) and the Final Rule, 61 FR 44978, 44979 (August 9, 1995) ("the exemption applies when the certification is used to identify an individual in a routine, non-intrusive, non-burdensome way.") This language reflects current guidance in OMB/OIRA's Information Collection Review Handbook (1989), which discusses exempt categories of inquiry (5 CFR 1320.3(h) (1)-(10)) that are not deemed to constitute "information." Certifications, as well as other forms of acknowledgments, comprise one of these categories.¹³ Such inquiries are considered to be routine because response to the requests rarely requires examination of records, usually does not require consideration about the correct answer, and usually is provided on a form supplied by the government. See OMB/OIRA Handbook, p. 29. Accordingly, OMB's regulations exempt certifications from the clearance requirement, provided that no information need be reported beyond certain basic identifying information.

¹³ Specifically, the first category consists of: "affidavits, oaths, affirmations, certifications, receipts, changes of address, consents, or acknowledgments." 5 CFR 1320(h)(1).

VII. Additional Information for Interested Persons

A. *Motions or Petitions*

Any motions or petitions in connection with this proceeding must be filed with the Secretary of the Commission.

B. *Communications by Outside Parties to Commissioners or their Advisors*

Pursuant to § 1.18(c) of the Commission Rules of Practice, 16 CFR 1.18(c), communications with respect to the merits of this proceeding from any outside party to any Commissioner or Commissioner's advisor during the course of this rulemaking shall be subject to the following treatment. Written communications, including written communications from members of Congress, shall be forwarded promptly to the Secretary for placement on the public record. Oral communications, not including oral communications from members of Congress, are permitted only when such oral communications are transcribed verbatim or summarized at the discretion of the Commissioner or Commissioner's advisor to whom such oral communications are made, and are promptly placed on the public record, together with any written communications relating to such oral communications. Memoranda prepared by a Commissioner or Commissioner's advisor setting forth the contents of any oral communications from members of Congress shall be placed promptly on the public record. If the communication with a member of Congress is transcribed verbatim or summarized, the transcript or summary will be placed promptly on the public record.

List of Subjects in 16 CFR Part 301

Furs Labeling, Trade practices.

Authority: 15 U.S.C. 69.

By direction of the Commission.

Donald S. Clark,

Secretary.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-209040-88]

RIN 1545-AM41

Qualified Electing Fund Elections

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations permitting certain shareholders to make a special election under section 1295, in lieu of the election currently provided for under that section, with respect to certain preferred shares of a passive foreign investment company (PFIC). A shareholder that makes a special election must account for dividend income on the shares subject to the special election under special income inclusion rules, rather than under the general income inclusion rules of section 1293. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by March 24, 1997. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for May 8, 1997, at 10:00 a.m. must be received by April 17, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-209040-88), 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-209040-88), 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 Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Judith Cavell Cohen, (202) 622-3880; 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 February 24, 1997. 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 § 1.1295-2(c)(3) and proposed regulation § 1.1295-2(e) and (f). This information will notify the Commissioner that certain shareholders have made the special election. In addition, this information will enable the IRS to determine if a shareholder qualifies for the special election and is satisfying the income inclusion requirements of proposed regulation § 1.1293-2. The collection of information is mandatory. The likely respondents are individuals, businesses, and other for-profit organizations.

Estimated total annual reporting/recordkeeping burden: 600 hours. The estimated annual burden per respondent varies from 21 minutes to 8.3 hours, depending on individual circumstances, with an estimated average of 35 minutes.

Estimated number of respondents: 1030.

Estimated annual frequency of responses: On occasion.

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.

Background

This document contains proposed Income Tax Regulations (26 CFR part 1) under sections 1293 and 1295 of the Internal Revenue Code. Sections 1293 and 1295 were added by the Tax Reform Act of 1986 (the Act) and were amended by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). The sections, as amended, were effective for taxable years of foreign corporations beginning after December 31, 1986. Section 1293 also was amended by the Omnibus Reconciliation Act of 1993 (OBRA). Guidance for making the section 1295 election was provided in proposed regulation § 1.1295-1 and Notice 88-125, 1988-2 C.B. 535. Guidance regarding the annual income inclusion rule for shareholders making a section 1295 election was provided in proposed regulation § 1.1293-1.

Explanation of Provisions

Special Preferred Section 1295 Election

1. Introduction

The passive foreign investment company (PFIC) rules of the Code are designed to eliminate potential tax deferral opportunities associated with equity investments by United States persons in foreign corporations that have substantial levels of passive income or assets. The PFIC rules eliminate tax deferral opportunities by applying the section 1291 interest charge regime to PFIC shareholders that fail to make a section 1295 annual income inclusion election (section 1295 election). In general, the section 1291 interest charge regime applies to the "extraordinary" portion of any distribution received by the shareholder, and any gain recognized on a disposition of shares.

The PFIC rules apply to investments in both common and preferred shares of a PFIC. Preferred shares, unlike common shares, generally provide for limited dividend and liquidation or redemption rights, and thus do not participate significantly in corporate growth. Accordingly, preferred shares of a PFIC generally do not afford U.S. investors with the same potential for U.S. tax deferral as common shares of a PFIC.

Preferred shareholders, like common shareholders, may make the section 1295 election to avoid the interest charge regime of section 1291. Shareholders that make the section 1295 election are required under section 1293

to include in income annually, as ordinary income, their pro rata share of the PFIC's ordinary earnings and, as long-term capital gain, their pro rata share of the PFIC's net capital gain for the year. In order to determine their pro rata share of ordinary earnings and net capital gain, shareholders that have made a section 1295 election must obtain certain U.S. tax accounting information from the PFIC regarding the PFIC's earnings. If this information is not available, the shareholders cannot make the section 1295 election. If the requisite information is available, the annual information reporting and collection requirements associated with the section 1295 election may render the election impractical for smaller investors. Because preferred shares often do not afford investors with significant tax-deferral opportunity, commenters have suggested that the current section 1295 election regime should be simplified for certain types of preferred shares.

The proposed regulations adopt a special section 1295 election regime that would require holders of certain preferred shares of a PFIC that elect to be subject to the regime to accrue annually ordinary dividend income with respect to the preferred shares regardless of the holder's pro rata share of ordinary earnings or net capital gain of the PFIC for the year. Because shareholders would accrue income regardless of the earnings and net capital gain of the PFIC, shareholders that elect to be subject to the regime would not have to report and collect any U.S. tax accounting information regarding the PFIC in order to make the special section 1295 election.

The proposed regulations are issued under two sections of the Code. Section 1.1295-2 of the proposed regulations provides rules for making a QEF election under the special proposed section 1295 election regime (special preferred QEF election). Section 1.1293-2 describes the annual income inclusion rules for shareholders that have made the special preferred QEF election.

The proposed regulations would apply only with respect to qualifying preferred shares issued after the date the proposed regulations are finalized.

2. Rules for Making the Special Preferred QEF Election

Under proposed regulation § 1.1295-2(a), the special preferred QEF election may be made in lieu of the section 1295 election described in proposed regulation § 1.1295-1 and Notice 88-125, 1988-2 C.B. 535 (regular section 1295 election), with respect to certain types of preferred shares (qualified

preferred shares) by certain holders satisfying prescribed ownership requirements.

The special preferred QEF election may only be made with respect to qualified preferred shares as defined in proposed regulation § 1.1295-2(b). To ensure that the special preferred QEF election cannot be used for tax avoidance purposes and to reduce complexity, the proposed regulations define qualified preferred shares narrowly to include only a limited class of preferred shares likely to be marketed to U.S. retail investors. Although the definition of qualified preferred shares includes both cumulative and non-cumulative preferred shares, the definition excludes various types of preferred shares, including preferred shares denominated in a foreign currency and preferred shares issued at a significant discount to their liquidation or redemption amounts. The PFIC issuing the preferred shares must represent that it intends to pay dividends currently. Proposed regulation § 1.1295-2(b) provides additional restrictions with respect to preferred shares acquired in secondary market transactions.

Proposed regulation § 1.1295-2(c) describes shareholders who may make the election. Under proposed regulation § 1.1295-2(c)(1), any United States person that acquires qualified preferred shares for cash or in certain nonrecognition transactions and that holds such shares directly may make the election. United States persons that are pass-through entities, including partnerships, S corporations, trusts and estates, may qualify as shareholders.

The special preferred QEF election regime is narrowly targeted to eliminate certain of the information reporting and collection requirements associated with the existing section 1295 election and annual inclusion rules for U.S. retail investors in preferred shares of PFICs. Treasury and the Service believe that the special preferred QEF election regime should only apply with respect to foreign corporations that are not expected to be in a position to provide U.S. tax accounting information to shareholders. Accordingly, proposed regulation § 1.1295-2(c)(2) provides that the special preferred QEF election does not apply to holders of preferred shares in a PFIC that is a controlled foreign corporation. Further, proposed regulation § 1.1295-2(c)(3) provides that the special preferred QEF election does not apply to holders that own 5 percent or more of the vote or value of any class of shares of the PFIC. Holders of five percent or more of the vote or value of any class of shares generally are not the

type of retail investor that the proposed regulations are designed to assist. Such holders may only make the section 1295 election provided under current rules.

Proposed regulation § 1.1295-2(c)(3) requires the corporation to provide to electing shareholders a statement, directly or in a disclosure document generally available to all U.S. shareholders, either that it is or that it reasonably believes that it is a PFIC and that it is not a controlled foreign corporation. Shareholders that fail to receive such a statement are not permitted to make a special preferred QEF election.

Proposed regulation § 1.1295-2(d) describes the effect of the special preferred QEF election. Proposed regulation § 1.1295-2(d)(1) provides that shares subject to a special preferred QEF election will be treated as shares of a pedigreed QEF (as defined in proposed regulation § 1.1291-1(b)(2)(ii)) for all taxable years of the foreign corporation that are included wholly or partly in the shareholder's holding period of the shares. Under the proposed regulations, the election will apply to all qualified preferred shares of a foreign corporation owned directly by the shareholder that are acquired in the taxable year with respect to which the election is made. Although a special preferred QEF election will not apply automatically to qualified preferred shares acquired in subsequent taxable years of a shareholder, the proposed regulations permit the shareholder to make separate special preferred QEF elections with respect to qualified preferred shares acquired in later years.

Proposed regulation § 1.1295-2(d)(2) provides that the special preferred QEF election regime applies whether or not the foreign corporation is a PFIC in any year subsequent to the year of the election. Accordingly, shareholders that make the special preferred QEF election must make annual § 1.1293-2 income inclusions, as provided in proposed regulation § 1.1295-2(d)(3), even if the foreign corporation does not qualify as a PFIC for a particular year.

Proposed regulation § 1.1295-2(e) specifies the time and manner of making the special preferred QEF election. In order to make the special preferred QEF election, a shareholder files Form 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund), for the taxable year of the election, checking the appropriate box in Form 8621, Part I, for making the section 1295 election, and indicating in the margin of Part I that the shareholder is making a special preferred QEF election with respect to certain specified shares. In addition, the

shareholder must attach to Form 8621 a brief statement containing the information and representations contained in proposed regulation § 1.1295-2(e)(2)(ii). Under proposed regulation § 1.1295-2(f), in subsequent years, the shareholder must file Form 8621 with respect to the foreign corporation but need not attach any statement to the form. For all taxable years covered by the election, the shareholder must report on Line 6a of Part II of Form 8621 the amount includible under proposed regulation § 1.1293-2 with respect to qualified preferred shares subject to a special preferred QEF election.

Proposed regulation § 1.1293-2(g) states that a sale, exchange or other disposition of shares subject to a special preferred QEF election terminates the election with respect to those shares. Also, the Commissioner may terminate or invalidate an election if a shareholder fails to satisfy the initial or ongoing requirements of the election. For example, the Commissioner may terminate or invalidate a special preferred QEF election if the shareholder owns five percent or more of the vote or value of any class of shares of the PFIC at any time during the period that the shareholder owns qualified preferred shares subject to the election. A shareholder may not itself terminate a special preferred QEF election.

3. Annual Inclusion Rules for Electing Shareholders.

Under proposed regulation § 1.1293-2(a), a shareholder that has made a special preferred QEF election must make annual income inclusions with respect to qualified preferred shares subject to the election. Unlike the annual income inclusions provided under section 1293 and proposed regulation § 1.1293-1, the annual inclusions under the special preferred QEF election regime are determined without regard to the shareholder's pro rata share of the foreign corporation's ordinary earnings or net capital gains.

Proposed regulation § 1.1293-2(b) provides rules for determining the amount that a shareholder must include in income annually under the special preferred QEF election regime. Under the proposed regulations, this annual amount consists of two components. The first component is an annual inclusion amount based on a ratable daily portion of dividend income that accrues on the qualified preferred shares (annual dividend amount). This ratable inclusion rule for the annual dividend amount is analogous to the rule for inclusion of income with respect to

periodic payments on notional principal contracts under § 1.446-3. The second component of the preferred QEF amount arises only in respect of fixed term preferred shares, as described proposed regulation § 1.1295-2(b)(vii), acquired in a secondary market transaction, and is calculated based on the ratable inclusion of the excess, if any, of the redemption price of the shares over the acquisition cost of the shares (preferred discount amount). This ratable inclusion rule for the preferred discount amount is analogous to the rule for the ratable inclusion of market discount on certain debt under section 1276(b)(1). The Service and Treasury solicit comments regarding the income inclusion rules of the proposed regulations, including comments as to whether foreign corporations and their agents could effectively assist holders in complying with the income inclusion rules applicable to preferred discount.

Proposed regulation § 1.1293-2(c) provides certain special rules regarding the annual income inclusion required under proposed regulation § 1.1293-2(a). Under § 1.1293-2(c)(1), annual amounts are included in income by shareholders irrespective of the PFIC's earnings and profits. In this regard, the special preferred QEF election differs from the regular section 1295 election in that shareholders making the special preferred QEF election must accrue the annual amount as ordinary income even if the amount exceeds the shareholder's pro rata share of the foreign corporation's earnings and profits. Proposed regulation § 1.1293-2(c)(3) requires the shareholder to include the annual dividend amount as ordinary income regardless of whether any portion of the PFIC's earnings for the year represents net capital gain. Proposed regulation § 1.1293-2(c)(4) provides rules for the tax-free distribution of previously taxed amounts. Proposed regulation § 1.1293-2(c)(5) provides certain basis adjustment rules similar to the basis adjustment rule of section 1293(d). Finally, proposed regulation § 1.1293-2(c)(6) provides rules intended to limit the effect of a special preferred QEF election to the shareholder making the election. Accordingly, a special preferred QEF election will not affect the foreign corporation's calculation of its earnings and profits, and will have no consequences for shareholders that have not made a special preferred QEF election.

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. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations represent a wholly elective simpler alternative to the section 1295 election described in § 1.1295-1 and Notice 88-125, 1988-2 C.B. 535, and impose a lighter collection of information burden. Further, the requirement that electing shareholders indicate their special election on Form 8621 annually and attach a statement, providing certain information in the first year of the election only, is minimal and will not impose a significant economic impact on electing shareholders. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) 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.

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 May 8, 1997, at 10:00 a.m. in room 3313, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building 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 March 24, 1997, 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 April 17, 1997.

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 author of these regulations is Judith Cavell Cohen of the

Office of Associate Chief Counsel (International).

However, other personnel from the IRS and Treasury Department participated in their development.

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 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.1293-2 also issued under 26 U.S.C. 1297(f).
Section 1.1295-2 also issued under 26 U.S.C. 1297(f). * * *

Par. 2. Section 1.1293-2 is added to read as follows:

§ 1.1293-2 Special Inclusion Rules for Special Preferred QEF Election.

(a) *In general.* A shareholder (including a shareholder that is a pass-through entity, as described in § 1.1295-2(c)(1)) that makes a special preferred QEF election under § 1.1295-2 must, regardless of the shareholder's method of accounting, include in income in respect of each share subject to the election, an annual amount (preferred QEF amount) determined according to the rules of paragraph (b) of this section. A shareholder that makes a special preferred QEF election must include the preferred QEF amount in income under this section for each year in which the taxpayer continues to hold a share that is subject to the election. The rules of this section apply in lieu of the general rules of section 1293 and § 1.1293-1.¹

(b) *Preferred QEF amount—(1) In general.* The preferred QEF amount for any share subject to a special preferred QEF election is the sum of the ratable daily portion of each periodic dividend amount (as described in paragraph (b)(2) of this section) on the share for the taxable year of the shareholder to which that portion relates, plus the preferred discount amount (as defined below), if any, for the taxable year. For purposes of this section, the preferred discount amount for a taxable year is the amount that bears the same ratio to the total amount of preferred discount (as described in § 1.1295-2(b)(2)(i)) on the share as the number of days that the taxpayer held the share in the taxable

¹ This proposed regulation was published on April 1, 1992, at 57 FR 11024.

year bears to the number of days after the date the taxpayer acquired the share and up to (and including) the share's redemption date as established under the principles of § 1.305-5(b). Notwithstanding the preceding sentence, the preferred discount amount for a taxable year is zero if the preferred discount on the share at the time of its acquisition by the shareholder was less than an amount equal to $\frac{1}{4}$ of 1 percent of the redemption price of the stock, multiplied by the number of complete years from the date of acquisition of the stock to the redemption date of the stock.

(2) *Periodic dividend amount.* A periodic dividend amount is the amount payable with respect to a share, whether on a cumulative or noncumulative basis, for a period (wholly or partly within the shareholder's taxable year) for which dividends on the share are calculated based upon the redemption or liquidation price of the share multiplied by a fixed percentage rate.

(c) *Special rules of application—(1) Earnings and profits disregarded.* The amounts to be included in income pursuant to this section are determined without regard to the earnings and profits of the foreign corporation with respect to which the special preferred QEF election applies.

(2) *Year of inclusion.* The shareholder includes the preferred QEF amount in its taxable year without regard to the taxable year of the foreign corporation with respect to which the special preferred QEF election applies.

(3) *Character of inclusions.* The shareholder includes all preferred QEF amounts in income as ordinary earnings.

(4) *Treatment of distributions.* Distributions received by a shareholder on shares subject to a special preferred QEF election that are paid out of earnings and profits of the foreign corporation are not included in gross income of the shareholder to the extent the distributions do not exceed the preferred QEF amounts (other than any portion of preferred QEF amounts consisting of preferred discount amounts) previously includible in income pursuant to this section. These distributions will, however, be treated as dividends for all other purposes of the Code and regulations. Amounts distributed to a shareholder with respect to shares subject to a special preferred QEF election that exceed amounts previously included in income under this section with respect to such shares are treated for all purposes of the Code and regulations as a distribution of property subject to the rules of section 301.

(5) *Basis adjustment rules.* The adjusted basis of a shareholder in shares that are subject to a special preferred QEF election shall be—

(i) Increased by any amount that is included in the gross income of the shareholder under paragraph (a) of this section; and

(ii) Decreased by any dividends (not to exceed the amount included in gross income under paragraph (a) of this section) actually paid to the shareholder in respect of such shares.

(6) *Effect limited to electing shareholder.* This section does not apply to the foreign corporation with respect to which a special preferred QEF election applies. Accordingly, the provisions of this section will not affect the foreign corporation's calculation of its earnings and profits for any purpose of the Code or regulations. In addition, the rules of this section apply only for purposes of determining the tax consequences for holders of shares subject to the election. Thus, the election shall have no effect on the application of the Code or regulations with respect to the tax consequences of the ownership of shares that are not subject to the election, including for purposes of determining whether any distributions from the foreign corporation with respect to such shares should be treated as having been included in the income of any United States person pursuant to section 1293(c) or section 959.

(d) *Examples.* The following examples illustrate the rules of paragraphs (a), (b) and (c) of this section. Although these examples assume a 30-day month, 360-day year, any reasonable counting method may be used to compute the length of accrual periods. For purposes of simplicity, the relevant amounts as stated are rounded to two decimal places. However, the computations do not reflect any such rounding convention. The examples are as follows:

Example 1. *Preferred QEF amount—(i) Facts.* (A) On May 1, 1998, A, an individual who files his returns on a calendar year basis, purchased for \$10,000 in a single secondary market transaction 100 shares of nonconvertible Class A \$100 par value preferred stock (the Class A Stock) of FC, a foreign corporation with a taxable year ending on March 31.

(B) The terms of the Class A Stock provide for a mandatory redemption of the Class A Stock by the issuer at par on June 1, 2012. The Class A Stock is not redeemable pursuant to an issuer call or holder put on any other date. Each share of Class A Stock provides for a semi-annual cumulative distribution payable in dollars on June 1 and December 1 equal to one-half the product of the par value of the Class A Stock and the

applicable annual dollar LIBOR in effect on the distribution date immediately prior to the relevant distribution date. The shares of the Class A stock are qualified preferred shares in the hands of A. A purchases no other qualified preferred shares of FC during its 1998 or 1999 taxable years.

(C) A made a special preferred QEF election for A's taxable year ended December 31, 1998, which applies to the Class A Stock acquired by A on May 1, 1998. FC is a PFIC under section 1296 for its taxable year ending March 31, 1999, but FC is not a PFIC for its taxable year ending March 31, 2000. FC paid no current dividends on June 1, 1998, and December 1, 1998, paid the June 1, 1999, dividend currently on June 1, 1999, together with accumulated distributions from June 1, 1998, and December 1, 1998, and paid the December 1, 1999, dividend currently on December 1, 1999. The applicable annual LIBOR is 8 percent on December 1, 1997, 7 percent on June 1, 1998, 9 percent on December 1, 1998, 10 percent on June 1, 1999, and 9 percent on December 1, 1999. FC had sufficient earnings and profits, within the meaning of section 312, for its taxable year ending on March 31, 2000, so that actual distributions to all shareholders of Class A Stock in that year were treated as paid out of earnings and profits of FC.

(ii) *Tax consequences to A for A's taxable year ending December 31, 1998.* As required under paragraph (a) of this section, A must include in gross income for its 1998 taxable year the 1998 preferred QEF amount. The preferred QEF amount, as determined under paragraph (b) of this section, for A's 1998 taxable year is the ratable portion of each periodic dividend amount for that year. For 1998, there are three periodic dividend amounts: The periodic dividend amount for the period from December 1, 1997, to June 1, 1998 (periodic dividend amount 1), the periodic dividend amount for the period from June 1, 1998, to December 1, 1998 (periodic dividend amount 2), and the periodic dividend amount for the period from December 1, 1998, to June 1, 1999 (periodic dividend amount 3). Periodic dividend amount 1 in respect of each share owned by A is \$4 (1/2 multiplied by the applicable annual LIBOR of 8 percent set on December 1, 1997, multiplied by the \$100 amount payable on redemption). Because A acquired the shares on May 1, 1998, A's ratable portion of periodic dividend amount 1 for 1998 is approximately \$.67 (30/180 multiplied by \$4) per share. Periodic dividend amount 2 in respect of each share owned by A is \$3.50 (1/2 multiplied by the applicable annual LIBOR of 7 percent set on June 1, 1998, multiplied by \$100). Because A owned the shares for the entire period associated with periodic dividend amount 2, A's ratable portion of periodic dividend amount 2 for 1998 is the full \$3.50 per share. Periodic dividend amount 3 in respect of each share owned by A is \$4.50 (1/2 multiplied by the applicable annual LIBOR of 9 percent set on December 1, 1998, multiplied by \$100). Because the portion of 1998 associated with periodic dividend amount 3 is only the month of December, 1998, A's ratable portion of periodic dividend amount 3 for 1998 is approximately

\$.75 (30/180 multiplied by \$4.50).

Accordingly, A's preferred QEF amount for 1998 is approximately \$4.92 (\$.67 + \$3.5 + \$.75) per share. A must include approximately \$492 (approximately \$4.92 per share, multiplied by 100 shares) in income as ordinary earnings for its 1998 tax year even though FC paid no actual dividend to shareholders of Class A Stock for the period in 1998 during which A held the Class A Stock.

(iii) *Tax consequences to A for A's taxable year ending December 31, 1999.* As required under paragraph (a) of this section, A includes in gross income for its 1999 taxable year its preferred QEF amount for 1999. The preferred QEF amount, as determined under paragraph (b) of this section, for A's 1999 taxable year is the ratable portion of each periodic dividend amount for that year. For 1999, there are three periodic dividend amounts: The periodic dividend amount for the period from December 1, 1998, to June 1, 1999 (periodic dividend amount 1), the periodic dividend amount for the period from June 1, 1999, to December 1, 1999 (periodic dividend amount 2), and the periodic dividend amount for the period from December 1, 1999, to June 1, 2000 (periodic dividend amount 3). Periodic dividend amount 1 in respect of each share owned by A is \$4.50 (1/2 multiplied by the applicable annual LIBOR of 9 percent set on December 1, 1998, multiplied by \$100). Because A held each share of Class A Stock for five months in 1999 for the period associated with periodic dividend amount 1, A's ratable portion of periodic dividend amount 1 for 1999 is approximately \$3.75 (150/180 multiplied by \$4.50). Periodic dividend amount 2 in respect of each share owned by A is \$5 (1/2 multiplied by the applicable annual LIBOR of 10 percent set on June 1, 1999, multiplied by \$100). Because A owned the share for the entire period associated with periodic dividend amount 2, A's ratable portion of periodic dividend amount 2 for 1999 is the full \$5. Periodic dividend amount 3 in respect of each share owned by A is \$4.50 (1/2 multiplied by the applicable annual LIBOR of 9 percent set on December 1, 1999, multiplied by \$100). Because A held each share of Class A Stock for one month in 1999 for the period associated with periodic dividend amount 3, A's ratable portion of periodic dividend amount 3 for 1999 is approximately \$.75 (30/180 multiplied by \$4.50). Accordingly, A's preferred QEF amount for 1998 is approximately \$9.50 (\$3.75 + \$5 + \$.75). A must include approximately \$950 (\$9.50 per share, multiplied by 100 shares) in income as ordinary income for its 1999 taxable year even though FC was not a PFIC for FC's taxable year ending in 2000. The current distributions and arrearages actually paid to A with respect to the Class A Stock are not includible in income by A under paragraph (c)(4) of this section because they constitute amounts previously included in income.

Example 2. Preferred Discount—(i) Facts. The facts are the same as in *Example 1* except that A acquired the 100 shares of Class A Stock for \$9000.

(ii) *Tax Consequences to A for A's taxable year ending December 31, 1998.* (A) Because

the Class A Stock is fixed term preferred stock (as described in § 1.1295-2(b)(1)(vii)) and A acquired each share of the Class A stock with \$10 of preferred discount, as described in § 1.1295-2(b)(2), A's preferred QEF amount to be included by A for the taxable year consists of the sum of the ratable daily portion of each periodic dividend amount, as calculated in paragraph (d)(ii) of *Example 1* of this section, plus the preferred discount amount described in paragraph (b)(1) of this section.

(B) The preferred discount amount with respect to each share is approximately \$.47 (\$10 multiplied by 240 days/5070 days to maturity). A must include approximately \$47 (\$.47 per share, multiplied by 100 shares), together with the amount calculated in paragraph (d)(ii) of *Example 1* of this section, in income as ordinary earnings for its 1998 tax year even though FC paid no actual dividend to shareholders of Class A Shares for the period in 1998 during which A held the Class A Stock.

(iii) *Tax consequences to A for A's taxable year ending December 31, 1999.* The portion of the preferred discount on each share includible under paragraph (a) of this section is approximately \$.71 (\$10 multiplied by 360 days/5070 days to maturity). A must include this amount, together with the amount calculated in paragraph (d)(iii) of *Example 1* of this section, in income as ordinary earnings for its 1999 tax year even though FC was not a PFIC for FC's taxable year ending in 2000. The current distributions and arrearages actually paid to A in 1999 with respect to the Class A Stock are not includible in income by A under paragraph (c)(4) of this section, because they constitute amounts previously included in income.

(e) *Effective date.* The rules under this section apply with respect to qualified preferred stock subject to a special preferred QEF election made after the date that is 30 days after the date of publication of this document as a final regulation.

Par. 3. Section 1.1295-2 is added to read as follows:

§ 1.1295-2 Special Preferred QEF Election.

(a) *In general.* This section provides rules permitting certain shareholders to make a special election under section 1295 (special preferred QEF election) in lieu of the election described in § 1.1295-1² and Notice 88-125, 1988-2 C.B. 535 (see § 601.601(d)(2)(ii)(b) of this chapter), with respect to certain preferred shares (qualified preferred shares) of a foreign corporation that certifies either that it is a PFIC (as defined in § 1.1291-1(b)(1)(i))³ or that it reasonably believes that it is a PFIC. In order to make a special preferred QEF election, a shareholder must satisfy the stock ownership requirement of

² This proposed regulation was published on April 1, 1992, at 57 FR 11024.

³ This proposed regulation was published on April 1, 1992, at 57 FR 11024.

paragraph (c)(2) of this section. A special preferred QEF election of a shareholder applies only to those qualified preferred shares acquired and held directly by the shareholder in the taxable year of the shareholder for which the election is made. A shareholder making a special preferred QEF election must account for dividend income on shares subject to the election under the special income inclusion rules described in § 1.1293-2, rather than under the general income inclusion rules of section 1293 and § 1.1293-1. In addition, for purposes of determining the tax consequences of owning shares subject to the special preferred QEF election, an electing shareholder must treat the foreign corporation as a PFIC for the entire period during which the shareholder continues to hold any of such shares. Paragraph (b) of this section defines qualified preferred share. Paragraph (c) of this section provides rules for determining who may make the special preferred QEF election. Paragraph (d) of this section provides rules concerning the effect of the election. Paragraph (e) of this section provides rules for the time and manner of making the election. Paragraph (f) of this section sets forth the annual reporting requirement for the election. Paragraph (g) of this section provides rules concerning the possible termination or invalidation of the election. For the applicability date of this section, see paragraph (h) of this section.

(b) *Qualified preferred share defined—(1) In general.* For purposes of this section, a share of a foreign corporation is a qualified preferred share only if—

(i) The share was originally issued for cash or in exchange for qualified preferred shares of the foreign corporation in a transaction to which section 354(a)(1) applied;

(ii) If the share were to constitute a debt obligation, the share would be in registered form within the meaning of § 5f.103-1(c) of this chapter;

(iii) All amounts payable with respect to the share are denominated in U.S. dollars and are not determined by reference to the value of a currency other than the U.S. dollar;

(iv) The share is limited and preferred as to dividends and does not participate in corporate growth to any significant extent within the meaning of section 1504(a)(4)(B);

(v) The share has a fixed redemption or liquidation price;

(vi) The share provides for cumulative or noncumulative dividend rights that are limited to an annual (or shorter period) amount computed by

multiplying either the redemption or liquidation price of the share by a specified index described in § 1.446-3(c)(2)(i), (iii), or (iv) (specified index), or by a specified index periodically re-established pursuant to an auction reset mechanism, set in advance of the period with respect to which the specified index applies;

(vii) If the share may be redeemed under circumstances described in § 1.305-5(b) such that redemption premium (as described in § 1.305-5(b)) could be treated under section 305(c) as a constructive distribution (fixed term preferred stock), the share was not issued with redemption premium exceeding the de minimis amount described in section 305(c)(1) and § 1.305-5(b)(1);

(viii) If the share may not be redeemed under circumstances described in § 1.305-5(b) such that redemption premium would not be treated under section 305 as a constructive distribution (perpetual preferred stock), the share does not provide shareholders with the right to receive an amount upon liquidation or redemption that exceeds the issue price of the share (as determined under the principles of section 1273(b)) by an amount in excess of 5 percent of such liquidation or redemption amount;

(ix) If redeemable, the share is redeemable only in whole and not in part and is not subject to mandatory redemption within five years of the issue date of the share. Further, the share is not subject to a holder put or issuer call that, based on all the facts and circumstances as of the issue date of the share, is more likely than not to be exercised at a time within five years of the issue date;

(x) If convertible, the share is not convertible into a share other than a share meeting all the conditions set forth in paragraphs (b)(1)(i) through (b)(1)(ix) of this section; and

(xi) The issuer of the share has indicated in an offering document relating to the original issuance of the share or in a written statement available to U.S. holders that the issuer has no current intention or belief that it will not pay dividends on the share on a current basis and that the share meets the conditions set forth in paragraphs (b)(1)(i) through (b)(1)(x) of this section and this paragraph (b)(1)(xi).

(2) *Special rules for shares acquired in secondary market transactions—(i) Fixed term preferred stock.* A share of fixed term preferred stock (as described in paragraph (b)(1)(vii) of this section) that satisfies the conditions set forth in paragraph (b)(1) of this section and that is acquired in a transaction other than

in connection with the initial issuance of the share (a secondary market transaction), shall constitute a qualified preferred share with respect to a shareholder, but only if the shareholder acquires the share for cash and the share has preferred discount (as defined below) that is less than or equal to an amount equal to 1 percent of the redemption price, multiplied by the number of complete years from the date of acquisition of the share to the redemption date as established under the principles of § 1.305-5(b). Sales of shares to bond houses, brokers, or similar persons or organizations acting in the capacity as underwriters, placement agents, or wholesalers are ignored for purposes of determining whether a share is acquired in connection with the initial issuance of the share. For purposes of this section, the preferred discount for a share is the excess of the redemption price of the share payable on the redemption date over the shareholder's acquisition cost for the share.

(ii) *Perpetual preferred stock.* A share of perpetual preferred stock, within the meaning of paragraph (b)(1)(viii) of this section, that satisfies the conditions set forth in paragraph (b)(1) of this section and that is acquired in a secondary market transaction, shall constitute a qualified preferred share with respect to the shareholder, but only if the shareholder acquires the share for cash and the amount payable upon liquidation of the share exceeds the shareholder's acquisition cost for the share by an amount less than or equal to 10 percent of such liquidation amount.

(iii) *Examples.* The following examples illustrate the rules of this paragraph (b)(2).

Example 1—(i) Facts. On May 1, 1998, A, an individual who files her return on a calendar year basis, purchases for \$9000 cash in a single secondary market transaction (as defined in paragraph (b)(2)(i) of this section) 100 shares of nonconvertible Class A \$100 par value preferred stock (Class A Stock) of FC, a foreign corporation with a taxable year ending March 31. The terms of the Class A Stock satisfy all the conditions described in paragraph (b)(1) of this section and provide for a mandatory redemption of the Class A Stock by the issuer in U.S. dollars at par on June 1, 2012. The Class A Stock is not redeemable pursuant to an issuer call or holder put on any other date.

(ii) *Analysis.* In order for A to make a special preferred QEF election with respect to the Class A Stock acquired by A, the Class A Stock acquired must constitute qualified preferred shares. Although the Class A Stock meets the requirements for qualified preferred shares set forth in paragraph (b)(1) of this section, the stock also must satisfy the requirements described in paragraph (b)(2)

because A acquired the stock in a secondary market transaction. Because the terms of the Class A Stock provide that the stock will be redeemed by the issuer on June 1, 2012, the stock constitutes fixed term preferred stock within the meaning of paragraph (b)(1)(vii) of this section. A purchased the Class A Stock for \$90 per share, representing a \$10 discount (\$100 June 1, 2012, per share redemption price less \$90 acquisition cost). Because this \$10 discount, which constitutes preferred discount within the meaning of paragraph (b)(2)(i) of this section, is less than \$14 (1 percent of the redemption price multiplied by 14 (the number of complete years until the mandatory redemption date)), the Class A Stock acquired by A satisfies the conditions of paragraph (b)(2)(i) of this section and therefore constitutes qualified preferred shares.

Example 2—(i) Facts. The facts are the same as in Example 1, except that A acquires the 100 shares of Class A Stock for \$8000.

(ii) *Analysis.* In this case, A purchased the Class A Stock for \$80 per share, representing a \$20 discount (\$100 June 1, 2012, redemption price less \$80 acquisition cost). Because this \$20 of preferred discount is greater than \$14 (1 percent of the redemption price multiplied by 14 (the number of complete years until the mandatory redemption date)), the Class A Stock fails to satisfy the conditions of paragraph (b)(2)(i) of this section and therefore fails to qualify as qualified preferred shares.

(c) *Who may make the election—(1) In general.* A U.S. person that acquires qualified preferred shares for cash or in a nonrecognition transaction described in § 1.1291-6(a)⁴ (nonrecognition transaction) and that holds such shares directly may make a special preferred QEF election, provided that, in the case of shares acquired in a nonrecognition transaction, either the qualified preferred shares are treated as stock of a pedigreed QEF, as defined in § 1.1291-1(b)(2)(ii), immediately prior to the nonrecognition transaction, or the gain, if any, realized on the transaction would be recognized under § 1.1291-6(b) with respect to the nonrecognition transaction. A special preferred QEF election will not apply to any shares with respect to which the electing shareholder is an indirect shareholder, within the meaning of § 1.1291-1(b)(8). Solely for purposes of this section, partnerships, S corporations, trusts and estates (pass-through entities) that directly own qualified preferred shares are treated as shareholders that may make a special preferred QEF election. A shareholder may not make a special preferred QEF election if at any time the shareholder made a section 1295 election (other than a special preferred QEF election) with respect to the foreign corporation. A shareholder may not

⁴ This proposed regulation was published on April 1, 1992, at 57 FR 11024.

make a special preferred QEF election unless the shareholder satisfies the stock ownership requirements set forth in paragraph (c)(2) of this section, and the shareholder receives from the foreign corporation the statement described in paragraph (c)(3) of this section.

(2) *Ownership requirement.* A holder of qualified preferred shares of a foreign corporation may make a special preferred QEF election only if, at all times during the taxable year of the shareholder, the shareholder does not own, directly, indirectly, or constructively, within the meaning of section 958, five percent or more of the vote or value of any class of stock of the foreign corporation. The five percent vote or value limitation must be satisfied for each taxable year of the shareholder during which the shareholder continues to hold shares subject to the special preferred QEF election.

(3) *Statement from corporation.* A shareholder may make the special preferred QEF election only if the foreign corporation has provided a written statement relating to the taxable year of the corporation that ends with or within the taxable year of the shareholder for which the election is made certifying either that the foreign corporation is, or that it reasonably believes that it is, a PFIC, and that it is not a controlled foreign corporation within the meaning of section 957(a) for such taxable year of the corporation. The statement must be provided directly to the electing shareholder or in a disclosure or other document generally available to all U.S. holders. Electing shareholders must retain a copy of the statement for their records.

(d) *Effect of election—(1) In general.* Unless terminated or invalidated pursuant to paragraph (g) of this section, shares subject to a special preferred QEF election will be treated as shares of a pedigreed QEF (as defined in § 1.1291-1(b)(2)(ii)) for all taxable years of the foreign corporation that are included wholly or partly in the shareholder's holding period of the shares. A special preferred QEF election applies to all qualified preferred shares owned directly by the shareholder that are acquired in the taxable year of the election. Separate special preferred QEF elections may be made for qualified preferred shares acquired in other taxable years of the taxpayer. A special preferred QEF election is personal to the shareholder that made the election and does not apply to a transferee of the shares. A shareholder that has made a special preferred QEF election may not make, with respect to the foreign

corporation, any other election permitted under sections 1291 through 1297 and the regulations under those sections, including a section 1295 election as described in § 1.1295-1 and Notice 88-125, 1988-2 C.B. 535 (see § 601.601(d)(2)(ii)(b) of this chapter), for any period during which the special preferred QEF election remains in effect with respect to any shares of the shareholder.

(2) *Continued PFIC Characterization.* By making the special preferred QEF election, the shareholder agrees to treat the foreign corporation as a PFIC with respect to qualified preferred shares subject to the election at all times during its holding period for such shares, without regard to whether the foreign corporation is a PFIC for any taxable year of the foreign corporation during which the preferred QEF election remains in effect.

(3) *Section 1293 inclusions.* For each taxable year of the shareholder to which an election under this section applies, the shareholder must include in income the preferred QEF amount, as defined in § 1.1293-2, in the manner and under the rules provided in that section.

(e) *Time for and manner of making the special preferred QEF election—(1) Time for making the election.* A special preferred QEF election must be made on or before the due date, as extended, for filing the shareholder's return for the taxable year during which the shareholder acquired the qualified preferred shares for which the election is being made. A special preferred QEF election may not be made for those shares at any other time pursuant to any other provision of the Code or regulations.

(2) *Manner of making the election—(i) In general.* A shareholder makes the special preferred QEF election under this section for all qualified preferred shares of a foreign corporation acquired during the shareholder's taxable year by checking the appropriate box in Form 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund), Part I, for making the section 1295 election, and indicating in the margin of Part I that the shareholder is making a special preferred QEF election with respect to certain specified shares. The shareholder also must report the preferred QEF amount for the taxable year of the election on Line 6a of Part II of Form 8621. In addition, the shareholder must attach to Form 8621 the statement (preferred QEF statement) described in paragraph (e)(2)(ii) of this section, signed by the shareholder under penalties of perjury, stating that the information and representations

provided in the preferred QEF statement are true, correct, and complete to the best of the shareholder's knowledge and belief.

(ii) *Preferred QEF statement contents.* The preferred QEF statement must include the following information and representations:

(A) The first taxable year of the shareholder for which the special preferred QEF election is made;

(B) The number of shares subject to the election, their acquisition date(s) and acquisition price(s), and the class designation(s) of the shares;

(C) A representation by the shareholder that it did not at any time during its taxable year own directly, indirectly, or constructively, within the meaning of section 958, five percent or more of the vote or value of any class of stock of the foreign corporation with respect to which the election applies;

(D) A representation by the shareholder that it has obtained the written statement described in paragraph (c)(3) of this section; and

(E) A representation by the shareholder that it has never made a section 1295 election other than a special preferred QEF election with respect to the foreign corporation.

(f) *Annual reporting requirement.* For each taxable year of a shareholder during which the shareholder holds shares of a foreign corporation subject to one or more special preferred QEF elections, the shareholder must file Form 8621 with respect to the foreign corporation regardless of whether the foreign corporation is or is not a PFIC under section 1296 during any portion of the taxable year. The shareholder must indicate in the margin of Part I of Form 8621 the number of special preferred QEF elections of the shareholder that remain in effect with respect to the foreign corporation. In addition, the shareholder must report, on Line 6a of Part II of Form 8621, the aggregate of the preferred QEF amounts for all relevant special preferred QEF elections in effect for the taxable year.

(g) *Termination or invalidation of election—(1) In general.* A sale, exchange or other disposition of a share that is subject to a special preferred QEF election will terminate the special preferred QEF election with respect to that share. In addition, the Commissioner may, in the Commissioner's discretion, terminate or invalidate a special preferred QEF election if a shareholder that made the election fails to satisfy the initial or ongoing requirements of the election. Once made, a special preferred QEF election may not be terminated or invalidated by the shareholder.

(2) *Effect of termination or invalidation.* Termination of a special preferred QEF election by the Commissioner will be effective on the first day of the shareholder's first taxable year following the last taxable year of the shareholder for which the requirements of the election are satisfied. For purposes of sections 1291 through 1297 and the regulations thereunder, the holding period of qualified preferred shares subject to an election that has been terminated will be treated as beginning on the effective date of the termination. A shareholder that has made an election that is invalidated by the Commissioner will be treated for purposes of sections 1291 through 1297 and the regulations thereunder as if the shareholder never made the election.

(h) *Effective date.* An election under this section may only be made with respect to qualified preferred shares that are issued after the date that is 30 days after the date of publication of this document as a final regulation.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

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POSTAL RATE COMMISSION

39 CFR Part 3001

[Docket No. RM97-1; Order No. 1146]

Rules of Practice and Procedure

AGENCY: Postal Rate Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commission proposes to amend its rules of practice and procedure to clarify what it requires under certain circumstances. Where the Postal Service files a request that proposes to change rates or fees and, at the same time, proposes to change established cost attribution principles, the proposed amendment would require the Postal Service's request to estimate the impact of its proposed changes in rates or fees separately from the impact of its proposed changes in attribution principles. The purpose of the proposed amendment is to require that such a request give other parties and the Commission adequate and timely notice of the impact of the rate proposals that it contains, in order not to delay evaluation of those proposals.

DATES: Comments must be filed by January 31, 1997.

ADDRESSES: Comments and correspondence should be sent to Margaret Crenshaw, Secretary of the

Commission, 1333 H Street, NW, Suite 300, Washington, D.C., 20268-0001.

FOR FURTHER INFORMATION CONTACT: Stephen Sharfman, Legal Advisor (202) 789-6820.

SUPPLEMENTARY INFORMATION: The basic purpose of Rule 54 of the Commission's Rules of Practice [39 CFR 3001.54] is to require the Postal Service to include with its request for changes in rates the threshold level of cost, volume, and revenue information necessary to support its direct case, so that its request can be evaluated within the tight deadline that the Act imposes. Most Rule 54 requirements also apply to Postal Service requests for classification changes, if such changes affect rates. See 39 CFR 3001.64. Evaluating the consistency of proposed changes in rates with the pricing standards of 39 USC 3622, requires accurate estimates of their impact. For this reason, Rule 54(a) requires the Postal Service to include with a request for changes in rates enough information to "fully inform" the Commission and the parties of the "significance and impact" of the proposed changes.

A Postal Service request for changes in rates cannot "fully inform" the Commission and the parties of its "significance and impact" if it does not show the effect that its proposed rates would have on the relative institutional cost burdens that the affected subclasses of mail would bear. The customary measure of relative institutional cost burdens is "cost coverage," i.e., the ratio of subclass revenue to subclass attributable cost. To satisfy Rule 54(a), therefore, the Postal Service's request must demonstrate the impact that its proposed rates would have on cost coverages. Docket No. MC96-3 is the most recent Postal Service request that involves proposals to significantly increase Postal Service revenues and rates. The Postal Service's Rule 54 cost presentation in that docket, however, did not satisfy this objective of Rule 54(a). It estimated only the combined effect on subclass attributable costs and cost coverages of its proposed changes in rates and its proposed changes in attribution principles. It left the task of distinguishing between these effects to other parties and the Commission.

It is not properly the Commission's or the parties' burden to disentangle the effects of the Postal Service's proposed changes in rates from the effects of its proposed changes in attribution principles, in order to evaluate the Postal Service's proposals. As the proponent of change, the Postal Service has the burden of going forward. See 5 USC 556(d), 39 USC 3622, 39 CFR

3001.53 and 3001.54. If the Postal Service's request confounds the effects of its proposals to change rates and its proposals to change cost attribution principles, its request does not provide timely and effective notice of the significance of either.

An important criterion for evaluating the significance and impact of proposed changes in rates is the effect that they would have on cost coverages. Because the attribution principles applied determine the amount of costs that are attributed to subclasses, they, too, affect cost coverages. When a Postal Service request combines proposals to change rates with proposals to change established cost attribution principles, mailers and competitors are not able to determine from the Postal Service's request how its proposed changes in attribution principles would affect their interests until they calculate for themselves what cost coverages would be at the Postal Service's proposed rates, under established attribution principles. For many potential participants in our hearings, performing this elaborate set of calculations is a formidable and time consuming task. It can defeat, or seriously delay, their ability to determine how the Postal Service's proposals would affect them, and whether they should intervene to support or oppose them. This is not consistent with the objective of Rule 54(a), which is to provide parties and the Commission with enough information from the outset of the proceeding to evaluate the significance and impact of the Postal Service's proposals.

To ensure timely and effective notice of the impact of Postal Service requests that propose to simultaneously change rates and attribution principles, the Commission proposes to amend Rule 54(a). The proposed amendment would require the Postal Service to include with such a request an alternate attributable cost presentation that would calculate attributable costs and cost coverages at Postal Service proposed rates according to established attribution principles. A cost presentation that holds attribution principles constant is necessary to isolate the effect of the Postal Service's proposed changes in rates on cost coverages. The appropriate set of attribution principles to use as a baseline is the set that was used to establish current rates. That set defines the status quo, is most consistent with historic attributable cost and cost coverage estimates, and has the weight of precedent.

As used in the proposed amendment to Rule 54(a), the phrase "attribution