HI, Maui, HI, INT Maui 096° and Hilo, HI, 336° radials; Hilo to INT Hilo 099° radial and long. 151°5′00″W.

* * * * *

V–17 [Revised]

From INT Lanai, HI, 106° and Maui, HI, 197° radials; Maui. From INT Koko Head, HI, 071° and Maui 347° radials; to INT Maui 347° and Lihue, HI, 065° radials.

* * * * *

V–22 [Revised]

From Molokai, HI, via INT Molokai 082° and Maui, HI, 329° radials; Maui; INT Maui 096° and Hilo, HI, 321° radials; Hilo; to INT Hilo 078° radial and long. 152°1′00″W.

* * * * *

Issued in Washington, DC, March 6, 1998.

Reginald C. Matthews,

Acting Program Director for Air Traffic Airspace Management.

[FR Doc. 98–6634 Filed 3–13–98; 8:45 am]

BILLING CODE 4910–13–P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

Amendments to Minimum Financial Requirements for Futures Commission Merchants

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rules.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') proposes to amend its minimum financial requirements for futures commission merchants (''FCMs''). The proposed amendment would eliminate the charge against the net capital of an FCM, presently required by rule 1.17(c)(5)(iii). The charge is four percent of the market value of options sold by customers trading on contract markets or foreign boards of trade. It is generally referred to as the ''short option value charge'' or ''SOV charge''. The original intent in adopting this rule was to require FCMs to provide additional capital to offset the risk of short options positions carried on behalf of customers. The Commission is proposing to rescind this rule because it has determined that the charge is not closely correlated to the actual risk of the options carried on behalf of customers and, in any event, there are adequate other protections in place to address the risk of short options. In particular, the Standard Portfolio Analysis of Risk (''SPAN'') margining system has been effectively used to set appropriate levels of risk margin and there are many other non-capital protections. These protections include effective self-regulatory organization (''SRO'') audit and financial surveillance programs and modern risk management and control systems at FCMs. Because of the demonstrated effectiveness of these programs, the Commission believes it may now be appropriate to rescind the SOV charge.

The Commission wishes to receive comments on this proposal. Comments are desired not only on the specific proposal itself, but also on all of the components of the system of protections that are designed to address the risk of short options, which are described below.

DATES: Comments must be received on or before May 15, 1998. Any requests for an extension of the comment period must be made in writing to the Commission within the comment period.

ADDRESSES: Comments may be sent to: Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581. Attn.: Secretariat with a reference to the Minimum Financial Requirement Rule—SOV Charge. Also, comments may be E-mailed to ''secretary@cftc.gov''.

FOR FURTHER INFORMATION CONTACT: Paul H. Bjarnason, Jr., Chief Accountant, 202–418–5459 or ''paulb@cftc.gov''; or Lawrence B. Patent, Associate Chief Counsel, 202–418–5439 or ''lpatent@cftc.gov''. Mailing address: Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581.

SUPPLEMENTARY INFORMATION:

I. Background

On July 7, 1982,[1] the Commission proposed amendments to the rule governing the computation of net capital for FCMs to recognize the difference in risk between the purchase and sale of commodity options. The sale of an option (''short option'') poses a greater risk to an FCM than does the purchase of an option (''long option'') because the risk of a short option is unlimited. In contrast, long options pose a risk to the carrying FCM which is limited to the premium on the option. Once the premium is collected from the customer who purchased the option, there is no further risk of financial loss to the FCM or the customer. In this connection, the Commission has proposed the repeal of Commission Regulation 33.4(a)(2) which requires the full payment of a commodity option premium at the time the option is purchased. The proposal was initially published for comment on December 19, 1997. The comment period was extended to March 4, 1998. The effect of the repeal would be to permit the futures-style margining of commodity options traded on regulated futures exchanges and is discussed in the initial notice of proposed rulemaking.[2]

To recognize the risk of carrying short options, the Commission adopted, effective September 21, 1982,[3] a safety factor charge of four percent of the market value of exchange-traded (domestic and foreign) options granted or sold by an FCM's customers—the short option value charge (''SOV charge''), as set forth in Regulation 1.17(c)(5)(iii).[4] However, over the years since its adoption, there have been complaints that the charge was not proportional to the risk of the options and was excessive in its financial burden upon the FCMs in terms of the cost of the capital required to carry the positions.

In June 1995, both the Chicago Board of Trade (''CBOT'') and the Chicago Mercantile Exchange (''CME'') urged the Commission to rescind the SOV charge. In the alternative, the two exchanges asked for some degree of relief from the SOV charge in the event that the Commission felt that complete rescission of the charge was not possible. Their letters cited, among other reasons for rescission or the requested relief, that: (a) Short options positions may serve to reduce the risk of a portfolio that would carry greater risk absent the short options positions, and (b) the risks of short option positions are already adequately addressed by the risk-based margining system currently being used by all commodity exchanges in the U.S. and many abroad.

They pointed out that the charge was adopted in 1982, prior to the development of risk-based margining systems. While the charge was intended to serve as an additional regulatory capital safety factor for option positions, they contended that it is now excessive and no longer justified because of the use of margining systems that

[1] 47 FR 30261 (July 13, 1982).

[2] 63 FR 6112 (February 6, 1998), Extension of comment period to March 4, 1998; See also 62 FR 66569 (December 19, 1997), Initial request for comment.

[3] 47 FR 41513 (September 21, 1982).

[4] Commission rules referred to herein can be found at 17 CFR Ch. I (1997).

adequately measure portfolio risk and, therefore, assess appropriate margins on the entire portfolio.

The Commission staff felt that there was some merit to the position of the exchanges and others who had criticized the efficacy of the SOV charge. Therefore, to temper the impact of the charge, while the matter was studied further, on July 26, 1995, the Division of Trading and Markets (''Division'') issued Interpretative Letter No. 95–65.[5] That letter provided partial relief through a ''no action'' position that would allow FCMs to reduce the four percent SOV charge applicable to short options positions carried by professional traders and market makers.[6] An FCM that wished to avail itself of the relief under the ''no action'' position was required to prepare certain supporting calculations and obtain approval from its designated self-regulatory organization (''DSRO'') to take the relief. The Division subsequently expanded this relief to include any customer account carried by an FCM, in Interpretative Letter No. 97–46, dated June 12, 1997, provided the same conditions could be met by the additional accounts.[7]

However, only five FCMs have taken advantage of the relief. This small number resulted from the fact that the relief required what were viewed as burdensome calculations and, in any event, the relief was limited to fifty percent of the total charge. The FCM community also communicated to the Commission that the relief provided by the Division failed to address the theoretical deficiencies of the rule. In a letter dated September 26, 1997, the Joint Audit Committee (''JAC'')[8] formally suggested that the net capital charge on SOV be eliminated. The JAC letter stated the following:

> * * * Since the limited relief was granted, the JAC has closely monitored the application of the relief. From JAC's experience and from discussions with FCMs, many firms feel that the conditions for relief are too restrictive and complicated. Thus, they are not able to expend their resources to take advantage of the relief. In fact, there are only five FCMs which have applied for such relief.
>
> During periods of high volatility, the capital charge will increase as the value of the applicable short option increases. However, this charge does not necessarily relate to the risk applicable to a particular options portfolio. Selling options may actually serve to reduce risk in a portfolio. As a result, some firms have made a business decision to refuse large, lucrative customer accounts due to an unwillingness to absorb the charge. The fact that this decision is made for cost rather than risk reasons is clearly not in the best interest of any participant in the U.S. futures industry. This outdated regulation forces the concentration of exchange traded short options in a few firms.
>
> In general, FCMs have little control over reducing the charge. Requiring additional collateral has no impact on the charge itself and will instead increase the FCM's capital requirements. We believe the SPAN[9] performance bond system adequately captures the risk in options portfolios and the undermargined charge to capital appropriately reflects risk in an FCM's capital computation.
>
> The charge has a significant impact on the viability of the exchange traded options markets. When market users can not find an FCM willing to absorb the charge, the liquidity of our markets is directly impacted. For all the reasons stated above, we again request the CFTC eliminate this charge in its entirety . . .

II. Discussion

As stated above, the Commission proposes that the SOV charge be rescinded for two reasons: (1) The rule has not resulted in capital charges proportionate to risk; and (2) the SPAN margining system and other non-capital components of the system of protections are much better developed and executed than they were when the SOV charge was first adopted. These factors are discussed below in two sections. The first section addresses the theoretical deficiencies of the SOV charge, and the second section is a summary of non-capital protections.

A. Theoretical Deficiencies of the SOV Charge

The current charge based on four percent of SOV has not, in practice, resulted in capital charges which are proportionate to risk. The following situations are illustrative:

Multiple Strikes—Exchanges typically list multiple strikes with the same underlying futures contract in a given option contract month. Option premium typically increases across strikes, moving from out-of-the-money strikes to in-the-money strikes. Moving to deep-in-the-money strikes increases the option intrinsic value and the resulting premium. At some deep-in-the-money point the deltas of the different strikes will be the same. Therefore, while two deep-in-the-money strikes may have very similar or even identical risk profiles, the deeper-in strike will have a higher intrinsic value and a higher premium, yielding a higher SOV charge. The SOV charges for the two options can differ 200 percent or more, even though those options have the same underlying futures, the same time to expiration, and the same risk profiles.

Risk-Reducing Strategies—Short options positions are often used as one component of a trading strategy. The other positions used in the strategy could be futures, other derivatives, or cash instruments. In such strategies, the short options positions may be intended as a risk-reducing position, as demonstrated by the fact that the introduction of the short options positions into the portfolio results in a reduction in the SPAN-based margin requirement for the portfolio. Despite the fact that these positions are risk-reducing, the short option values for these portfolios increase markedly in trending markets. In practice, the Commission notes that some FCMs which have carried the accounts of traders who do a great deal of these kinds of strategies have faced large capital charges in trending markets. Because the short options component of such strategies is actually risk-reducing, the SOV charge has not served its intended purpose in these cases.

The following examples will illustrate the problem with short calls. (Also, the same problem applies to short puts.)

Deep-In-The-Money Short Dated Short Call—A deep-in-the-money short dated short call has a risk profile essentially like a short futures position. The one major difference between the short call and the futures contract is that the call has a large intrinsic value which translates into a large premium and a corresponding large SOV charge. Therefore, FCMs incur a significant extra capital requirement for the short call even though there is no extra capital requirement to carry essentially the same risk with equivalent short futures contracts. In this case, the capital requirement is excessive compared to the risk, as indicated by the margin requirement on the futures contract.

Deep-Out-Of-The-Money Short Dated Call—A deep-out-of-the-money short dated call displays more of the unique risk characteristics associated with options. While initially it has a low

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[5] CFTC Interpretative Letter No. 95–65, [1994–1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,495 (July 26,1995).

[6] The reduction in the charge cannot exceed 50 percent of the pre-relief charge calculated for all SOV on a firm-wide basis.

[7] CFTC Interpretative Letter No. 97–46, [Current Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,086 (June 12,1997). This letter also provided some relief pertaining to the required supporting calculations.

[8] JAC is comprised of representatives from each commodity exchange and National Futures Association who coordinate the industry's audit and ongoing surveillance activities to promote a uniform framework of self-regulation.

[9] SPAN is an acronym for Standard Portfolio Analysis of Risk.

delta [10] this short call has a high gamma [11] as it approaches the money, introducing the potential for significant losses from extreme underlying moves. For normal underlying moves, this deep-out short call has little risk. Only extreme moves far beyond the normal performance bond coverage levels would cause significant losses for this option. However, because this deep-out short call has no intrinsic value and little time value, it typically has very low premium and therefore has a correspondingly low capital charge. Because this kind of risk rarely materializes into actual losses, it is best addressed by the non-capital protections. These protections are described below.

As discussed below, the Commission believes that the SPAN margining system, since its introduction in December 1988, appears to have provided adequate margins. Also, SPAN is being refined on an ongoing basis by the CME, the CBOT, and the other SROs which use it. Finally, the Commission has previously reported to the Federal Reserve Board that the SPAN margining system has met its performance goals for many years, with respect to futures margins on stock index futures contracts.

B. Summary of Non-Capital Protections

There are protections against the risk of short options other than net capital charges. In this connection, the Commission believes that the non-capital components of the system of protections in place are now stronger than they were when the SOV charge was put into place. Risk management models have been refined over the years; there have been enhancements in Commission and SRO audit and surveillance programs; FCM risk management systems and controls have improved significantly compared to what was available and in place at many firms when the SOV charge was first adopted; and technological advancements have improved communication among clearing organizations, FCMs and their customers. Therefore, the Commission has preliminarily concluded not only that the SOV charge has not worked to provide a risk-based protection, as hoped, but also that these other non-net capital protections have been improved over the years and have resulted in an overall strengthening of the system, well beyond what was in place when the SOV charge was adopted. The primary non-capital protections are described below.

Portfolio Margining System

Performance bond requirements are referred to commonly as ''margin'' requirements. Margin requirements typically are set at levels which cover 95 to 99 percent of a product's expected daily price change over a period of time. To ensure that margin requirements are set at appropriate levels, historical volatility price charts are reviewed by product and spreads between products. SPAN is a risk-measuring margin methodology adopted by all U.S. and numerous foreign futures exchanges. SPAN uses option pricing models to calculate the theoretical gains and losses on options under various market situations (*e.g.*, prices up, prices down, volatility up, volatility down, and extreme price movements). As noted above, the Commission has reported to the Federal Reserve Board on the effectiveness of SPAN in setting margins in equities-related futures contracts.

Financial Surveillance and Position Reporting Systems

Generally, it is the large traders which pose the greatest risk to FCMs. To deal with this risk, the U.S. futures industry has a very complete and current system of position reporting. This permits close monitoring of the positions of large traders and is the foundation of an effective program of financial surveillance conducted by the SROs. As explained below, current positions are assessed prospectively—what financial effect would such positions have if the market moved significantly one way or the other. The advanced reporting systems in place permit assessments to be done at the account level, which is where risk to the firms must be evaluated. Using account level data along with other information, the SROs' sophisticated programs are designed to identify risks to the clearing system, including financially troubled FCMs or FCMs that carry high-risk positions.

To accomplish this goal, SROs monitor market developments throughout the day, make intra-day variation margin calls on clearing members, and follow up with individual FCMs regarding potential problems. There have been occasions in the past when customers holding very large or concentrated positions have caused financial problems for their carrying FCMs. Large trader monitoring systems are designed to identify such traders before losses occur. Although it is not possible to obviate the possibility of an FCM failure due to the default of a large trader, the systems operated by the SROs improve the control of this risk by permitting scrutiny of large trader positions by the SROs. Scrutiny is carried out by the SROs on a systematic basis.

Using the large trader information, SROs perform stress testing of positions using ''what if'' price simulations based on open positions carried by clearing member FCMs in order to determine an FCM's potential risk in relation to its excess net capital. Daily pay/collect variation margin is aggregated for periods of time to monitor losses compared to the excess capital of the firm. Potential losses revealed by the stress testing, which are determined to be large in relation to an FCM's most recently reported capital, will indicate that the firm should be contacted by SRO surveillance staff to obtain assurances that the FCM has properly evaluated the creditworthiness of its customers and the adequacy of collateral in place.

As noted elsewhere, as a part of its oversight program, the Division regularly reviews the procedures used by the SROs to conduct financial surveillance over member-FCMs. The Division's reviews, as well as experience over many years working with the SROs in identified problem situations, reveal that the systems generally have been effective. The systems also have improved over time, because the SROs have shown a willingness to learn from experience. However, it should be noted that financial surveillance at the SRO level, including any review work done at an FCM during an in-field examination, is not a substitute for an effective risk management and control system operated by the FCM itself. The Commission believes that the audit and financial surveillance programs operated by the SROs have been effective in encouraging the development of equally good risk management and control systems at FCMs. In this connection, as explained below, the SROs ensure that FCMs have appropriate risk management and control systems in place and make recommendations when their in-field audits reveal inadequate systems.

Capital and Segregation Requirements for FCMs

The Commission's capital and segregation requirements are part of the protections built into the system against the risk of short options positions. All FCMs must meet the Commission's net capital and segregation requirements, as

[10] Delta measures the amount an option price changes for a one-point change in the price of the underlying product.

[11] Gamma is a risk variable that measures the amount that the delta of an option changes given a one-point change in the price of the underlying product.

well as SRO requirements. An FCM which is a clearing member also must have capital requirements which are higher than those set by the Commission. Commission regulations require firms to keep current books and records, prepare a daily segregation calculation and a formal, monthly capital calculation, among other things. FCMs must be in compliance with the net capital and segregation rules at all times. Material inadequacies in internal control must be reported. The demands of these recordkeeping and reporting requirements serve as an element of the overall system of internal controls. The daily segregation calculation, especially, will reveal problems in customers' accounts very quickly, when and if they occur.

The basic capital requirement is set at four percent of an FCM's liabilities to its customers. The segregation rule requires an FCM to have sufficient funds in segregation to meet its liabilities to its customers. The underlying concept of segregation is that by separating, i.e., segregating, the funds of customers from the proprietary funds of the FCM, there will be sufficient funds available to pay off the FCM's liabilities to its customers in the event of the FCM's failure due to proprietary losses. As already stated, in order to demonstrate to itself and regulators that it is in compliance with the segregation requirements, an FCM is required to prepare a daily computation of the status of the segregated accounts, which shows that there are sufficient funds in segregation. One of the elements of the computation is to ascertain the status of deficits in the accounts of customers. Any deficit which is not covered by appropriate collateral must be made up by the firm with funds of its own. Deficits outstanding for more than one day have a direct and immediate impact upon firm capital and may cause a firm to be undercapitalized. An FCM must report to the Commission in the event its capital falls below the early warning level, which is 150 percent of required capital. Although the capital rule provides some discretion to the Commission in allowing an FCM to come back into capital compliance, with respect to undersegregation, there is no grace period.[12] Therefore, it is prudent for an FCM to carry excess net capital and funds in segregation in amounts commensurate with the type of business it handles.

SRO Programs of In-Field Audits of FCMs

The Commission believes that the in-field audit program conducted by the SROs over their member-FCMs has resulted in a high level of compliance with the Commission's and the SROs' financial rules. Commission rules require SROs to have these programs in place. To this end, each FCM's DSRO conducts an annual audit of each FCM assigned to it under the Joint Audit Plan. Under the plan, a full-scope audit is conducted every other year, and a limited-scope records review is conducted in the alternate year. The audits are conducted according to the Joint Audit Program, which is designed and regularly updated for new developments by the JAC. The Commission reviews the Joint Audit Program each time it is updated.

The full-scope audit, conducted using the Joint Audit Program, includes a review of the systems and controls that the FCM has in place. In this connection, members of JAC complete a Financial and Risk Management Internal Controls questionnaire for each FCM audit. The questionnaire covers the firm's procedures for: opening new accounts, monitoring non-customer trading, assessing the impact of potential market movements on customer and non-customer trading, and ensuring that the segregation of duties is appropriate. Furthermore, during the course of the audit, a review is made of account documentation, margin procedures, undermargined account net capital charges, debit/deficit accounts and sales practices. Such reviews provide information to assess the firm's overall internal control and risk management procedures.

The JAC has initiated a project to revise its in-field audit approach to be more explicitly risk-based. That is, in planning and performing in-field audits, the DSRO will place a greater emphasis upon review and identification of potentially high risk areas at an FCM at the outset of an audit. The results of this early audit survey and planning work will translate into a more focused targeting by the DSRO of the total available audit resources upon the areas of highest risk at an FCM.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') 5 U.S.C. 601 *et seq.*, requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The Commission has previously determined that FCMs are not ''small entities'' for purposes of the Regulatory Flexibility Act.[13] Therefore, the Chairperson, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the action taken herein will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 [14] imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the Paperwork Reduction Act. While this proposed rule has no burden, the group of rules (3038–0024) of which this is a part has the following burden:

Average burden hours per response: 128.

Number of Respondents: 3143.

Frequency of response: On occasion.

Copies of the OMB-approved information collection package associated with this rule may be obtained from Desk Officer, CFTC, Office of Management and Budget, Room 10202, NEOB Washington, DC 20503, (202) 395–7340.

List of Subjects in 17 CFR Part 1

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements, Net capital requirements.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act and, in particular, Sections 4f, 4g and 8a (5) thereof, 7 U.S.C. 6d, 6g and 12a(5), the Commission hereby proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

Authority: 7 U.S.C. 1a, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24.

§ 1.17 [Amended]

2. Section 1.17(c)(5)(iii) is removed and reserved.

[12] The Commission has proposed to amend Regulation 1.12, its early warning notification rule, to add a requirement that an FCM promptly report to the Commission and the FCM's DSRO whenever it knows or should have known that it does not have sufficient funds in segregated accounts to meet its obligations to customers who are trading on U.S. markets or set aside in special accounts to meet its obligations to customers who are trading on non-U.S. markets. 63 FR 2188 (January 14, 1998).

[13] 47 FR 18619–18620.

[14] Pub. L. 104–13 (May 13, 1995).

Issued in Washington, DC on March 9, 1998, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 98–6580 Filed 3–13–98; 8:45 am]

BILLING CODE 6351–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–104062–97]

RIN 1545–AV88

Consolidated Returns—Limitations on the Use of Certain Credits and Related Tax Attributes

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations that relate to the use of certain tax credits and losses of a consolidated group and its members. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments and outlines of topics to be discussed at the public hearing scheduled for May 7, 1998, at 10 a.m., must be received by April 13, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R [REG–104062–97], room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R [REG–104005–98], 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 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 has been scheduled for May 7, 1998, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, in general, Roy A. Hirschhorn (202) 622–7770; concerning submissions and the hearing, Mike Slaughter (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) relating to section 1502. The temporary regulations provide rules that relate to the use of certain tax credits and related tax attributes of a consolidated group and its members. The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 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 principally affect corporations filing consolidated federal income tax returns that have carryover or carryback of credits from separate return limitation years. Available data indicates that many consolidated return filers are large companies (not small businesses). In addition, the data indicates that an insubstantial number of consolidated return filers that are smaller companies have credit carryovers or carrybacks, and thus even fewer of these filers have credit carryovers or carrybacks that are subject to the separate return limitation year rules. 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 (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for May 7, 1998, at 10 a.m., in room 2615. 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 who wish to present oral comments at the hearing must submit written comments and an outline of the topics (signed original and eight (8) copies) to be discussed by April 13, 1998.

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

An agenda showing the scheduling of the 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 Roy A. Hirschhorn of the Office of Assistant Chief Counsel (Corporate). Other personnel from the IRS and Treasury 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 26 CFR part 1 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.1502–3 also issued under 26 U.S.C. 1502.

Section 1.1502–4 also issued under 26 U.S.C. 1502.

Section 1.1502–9 also issued under 26 U.S.C. 1502. * * *

Section 1.1502–55 also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502–3, as proposed to be amended at 63 FR 1804, January 12, 1998, is amended by revising paragraphs (c)(3) and (d)(2) and adding paragraph (c)(4) to read as follows:

§ 1.1502–3 Consolidated investment credit.

* * * * *

(c) * * *

(3) and (4) [The text of proposed paragraphs (c) (3) and (4) of this section is the same as the text of § 1.1502–3T(c) (3) and (4) published elsewhere in this issue of the **Federal Register**.]

(d) * * *

(2) [The text of proposed paragraph (d)(2) of this section is the same as the