

## DEPARTMENT OF THE TREASURY

## Internal Revenue Service

## 26 CFR Part 1

[TD 8753]

RIN 1545-AV85

## Reorganizations; Nonqualified Preferred Stock

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Temporary regulations.

**SUMMARY:** This document contains a temporary regulation providing guidance under section 356(e) of the Internal Revenue Code (Code) on when nonqualified preferred stock (as defined in section 351(g)(2)) will not be treated as stock or securities for purposes of sections 354, 355, and 356 of the Code. The guidance also addresses the treatment of the receipt of a right to acquire nonqualified preferred stock. The temporary regulation provides that in some circumstances the terms *stock* and *securities* will not include nonqualified preferred stock, or a right to acquire such stock, when received in exchange for stock or rights to acquire stock. The text of this temporary regulation also serves as the text of the proposed regulation set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

**DATES:** This regulation is effective March 9, 1998.

**FOR FURTHER INFORMATION CONTACT:** Concerning the temporary regulation, Michael J. Danbury, (202) 622-7750 (not a toll-free number).

## SUPPLEMENTARY INFORMATION:

## Background and Explanation of Provisions

## A. In General

This document contains a temporary regulation under section 356(e) of the Internal Revenue Code as added by section 1014 of the Taxpayer Relief Act of 1997 (TRA of 1997), Public Law 105-34. Section 1014 of the TRA of 1997, enacted on August 5, 1997, amended sections 351, 354, 355, 356, and 1036 of the Code. As amended, sections 354, 355, and 356, in general, provide that nonqualified preferred stock (as defined in section 351(g)(2)) received in exchange for stock other than nonqualified preferred stock will not be treated as stock or securities but, instead, will be treated as "other property" or "boot." As a result, unless the transition rule of section 1014(f)(2)

of TRA of 1997 or another exception applies, the receipt of nonqualified preferred stock will result in gain recognition.

Section 351(g)(4) provides authority to issue regulations coordinating the rules for nonqualified preferred stock with other provisions of the Code. In connection with the issuance of final regulations treating certain rights to acquire stock as securities which can be received tax-free under sections 354, 355, and 356 (see §§ 1.354-1(e), 1.355-1(c), and 1.356-3(b) (TD 8752) also published in the Rules and Regulations section of this issue of the **Federal Register**), the IRS and Treasury became aware that additional rules were needed to address the treatment of rights to acquire nonqualified preferred stock to coordinate with new sections 354(a)(2)(C), 355(a)(3)(D), and 356(e). Accordingly, this temporary regulation provides that, notwithstanding §§ 1.354-1(e), 1.355-1(c), and 1.356-3(b), a right to acquire nonqualified preferred stock received in exchange for stock other than nonqualified preferred stock (or for a right to acquire stock other than nonqualified preferred stock) will not be treated as a security, and that nonqualified preferred stock received in exchange for stock other than nonqualified preferred stock (or for a right to acquire stock other than nonqualified preferred stock) will not be treated as stock or a security.

This regulation does not attempt to address all questions and issues that may arise regarding the exchange or receipt of nonqualified preferred stock. The IRS and Treasury recognize that further guidance is necessary on these matters and intend to provide it in the future. Accordingly, comments are requested not only on these temporary and proposed regulations, but also with regard to the types of guidance needed and other issues under section 351(g) and the related provisions.

## B. Effective Date

Except as provided in section 1014(f)(2) of TRA of 1997, this temporary regulation applies to nonqualified preferred stock (or a right to acquire such stock) received in connection with a transaction occurring on or after March 9, 1998.

## Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this

regulation. Because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking accompanying this regulation is being sent to the Small Business Administration for comment on its impact on small business.

**Drafting Information:** The principal author of this regulation is Michael J. Danbury of the Office of Assistant Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in its development.

## List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

## Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

## PART 1—INCOME TAXES

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

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

**Par. 2.** Section 1.356-6T is added to read as follows:

**§ 1.356-6T Rules for treatment of nonqualified preferred stock as "other property" (temporary).**

(a) *In general.* For purposes of §§ 1.354-1(e), 1.355-1(c), and 1.356-3(b), the terms *stock* and *securities* do not include—

(1) Nonqualified preferred stock, as defined in section 351(g)(2), received in exchange for (or in a distribution with respect to) stock, or a right to acquire stock, other than nonqualified preferred stock; or

(2) A right to acquire such nonqualified preferred stock, received in exchange for (or in a distribution with respect to) stock, or a right to acquire stock, other than nonqualified preferred stock.

(b) *Exceptions.* The following exceptions apply:

(1) *Certain recapitalizations.*

Paragraph (a) of this section does not apply in the case of a recapitalization under section 368(a)(1)(E) of a family-owned corporation as described in section 354(a)(2)(C)(ii)(II).

(2) *Transition rule.* Paragraph (a) of this section does not apply to a transaction described in section 1014(f)(2) of the Taxpayer Relief Act of 1997 (111 Stat. 921).

(c) *Effective date.* This section applies to nonqualified preferred stock, or a

right to acquire such stock, received in connection with a transaction occurring on or after March 9, 1998.

**Michael P. Dolan,**

*Deputy Commissioner of Internal Revenue.*

Approved: December 17, 1997.

**Donald C. Lubick,**

*Acting Assistant Secretary of the Treasury.*

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## DEPARTMENT OF VETERANS AFFAIRS

### 38 CFR Part 3

RIN 2900-A183

#### Minimum Income Annuity

**AGENCY:** Department of Veterans Affairs.

**ACTION:** Final rule.

**SUMMARY:** This document amends the Department of Veterans Affairs (VA) adjudication regulations to provide for payment of the minimum income annuity, authorized by Public Law 92-425 as amended, to certain surviving spouses. This amendment is necessary to reflect statutory revisions contained in the National Defense Authorization Act for Fiscal Year 1997 that transfers the responsibility for paying this benefit from the Department of Defense (DoD) to VA.

**EFFECTIVE DATE:** January 6, 1998.

**FOR FURTHER INFORMATION CONTACT:** John Bisset, Jr., Consultant, Regulations Staff, Compensation and Pension Service, Veterans Benefits Administration, 810 Vermont Avenue, NW, Washington, DC 20420, telephone (202) 273-7230.

**SUPPLEMENTARY INFORMATION:** Public Law 92-425, section 4, 86 Stat. 706, 712 (1972) (10 U.S.C. 1448 note), provides for payment of a guaranteed minimum annual income (the so-called minimum-income-widow annuity, hereinafter referred to as the minimum income annuity) to certain surviving spouses of persons entitled to military retired or retainer pay at the time of their death. To be eligible, a person must: (1) Be the surviving spouse of a military retiree who died on or before March 20, 1974; (2) be eligible for VA nonservice-connected death pension; (3) have annual income that is less than the maximum annual rate of pension under 38 U.S.C. 1541(b); and (4) be ineligible to receive an annuity under the Survivor Benefit Plan (10 U.S.C. 1447-1455).

Section 638 of the National Defense Authorization Act for Fiscal Year 1997, Public Law 104-201, section 638, 110 Stat. 2422, 2581, transfers responsibility

for the payment of the minimum income annuity to the Secretary of Veterans Affairs from DoD. However, DoD remains responsible for funding this benefit and determining basic eligibility. This transfer was effective on July 1, 1997, and applies with respect to payments of benefits for any month after June 1997.

VA published an interim rule with a request for comments to implement section 638 of Public Law 104-201 in the **Federal Register** of July 3, 1997 (62 FR 35970-72). Interested persons were invited to submit written comments on or before September 2, 1997. No comments were received. The interim rule is now adopted with a technical change noting that, as required by statute, in certain instances, the Department of Transportation will determine whether an individual meets the criteria of section 4(a) of Pub. L. 92-425 as amended.

The Secretary hereby certifies that this regulatory amendment will not have a significant economic impact on a substantial number of small entities as they are defined in the Regulatory Flexibility Act (RFA), 5 U.S.C. 601-612. The reason for this certification is that these amendments would not directly affect any small entities. Only VA beneficiaries could be directly affected. Therefore, pursuant to 5 U.S.C. 605(b), these amendments are exempt from the initial and final regulatory flexibility analysis requirements of sections 603 and 604.

The Catalog of Federal Domestic Assistance program number is 64.105.

#### List of Subjects in 38 CFR Part 3

Administrative practice and procedure, Claims, Disability benefits, Health care, Pensions, Veterans, Vietnam.

Approved: December 23, 1997.

**Hershel W. Gober,**

*Acting Secretary of Veterans Affairs.*

For the reasons set forth in the preamble, the amendment to 38 CFR part 3 published July 3, 1997 (62 FR 35970) is adopted as final with the following changes:

### PART 3—ADJUDICATION

#### Subpart A—Pension, Compensation, and Dependency and Indemnity Compensation

1. The authority citation for part 3, subpart A continues to read as follows:

**Authority:** 38 U.S.C. 501(a), unless otherwise noted.

2. Section 3.811 is revised to read as follows:

#### § 3.811 Minimum income annuity.

(a) *Eligibility.* The minimum income annuity authorized by Public Law 92-425 as amended is payable to a person:

(1) Whom the Department of Defense or the Department of Transportation has determined meets the eligibility criteria of section 4(a) of Pub. L. 92-425 as amended other than section 4(a)(1) and (2); and

(2) Who is eligible for pension under subchapter III of chapter 15 of title 38, United States Code, or section 306 of the Veterans' and Survivors' Pension Improvement Act of 1978; and

(3) Whose annual income, as determined in establishing pension eligibility, is less than the maximum annual rate of pension in effect under 38 U.S.C. 1541(b).

(b) *Computation of the minimum income annuity payment—*(1) *Annual income.* VA will determine a beneficiary's annual income for minimum income annuity purposes under the provisions of §§ 3.271 and 3.272 of this part for beneficiaries receiving improved pension, or under §§ 3.260 through 3.262 of this part for beneficiaries receiving old law or section 306 pensions, except that the amount of the minimum income annuity will be excluded from the calculation.

(2) VA will determine the minimum income annuity payment for beneficiaries entitled to improved pension by subtracting the annual income for minimum income annuity purposes from the maximum annual pension rate under 38 U.S.C. 1541(b).

(3) VA will determine the minimum income annuity payment for beneficiaries receiving old law and section 306 pensions by reducing the maximum annual pension rate under 38 U.S.C. 1541(b) by the amount of the Retired Servicemen's Family Protection Plan benefit, if any, that the beneficiary receives and subtracting from that amount the annual income for minimum income annuity purposes.

(4) VA will recompute the monthly minimum income annuity payment whenever there is a change to the maximum annual rate of pension in effect under 38 U.S.C. 1541(b), and whenever there is a change in the beneficiary's income.

(c) An individual otherwise eligible for pension under subchapter III of chapter 15 of title 38, United States Code, or section 306 of the Veterans' and Survivors' Pension Improvement Act of 1978 shall be considered eligible for pension for purposes of determining eligibility for the minimum income annuity even though as a result of adding the amount of the minimum