final rule on the July 2, 1991, proposal. As proposed, FDA adopted minimum Brix values in § 101.30 for 51 fruit and vegetable juice products, including values for all of the fruits listed in the canned fruit nectars standard. In adopting the final Brix values, FDA considered the minimum Brix values in the stayed canned fruit nectars standard along with the information received in comments on the proposal. Thus, the agency concludes that the Brix values in the canned fruit nectars standard have been effectively superceded by the values in § 101.30. Moreover, § 101.30 requires that the label of products that purport to contain fruit or vegetable juice, including canned fruit nectars, declare the total percentage of juice contained in such products. This provision ensures that consumers will be able to make value comparisons based on the level of juice used in the beverage.

Finally, in the January 6, 1993, final rule, FDA adopted § 102.33 on the common or usual names of juice beverages that purport to contain fruit or vegetable juice. Canned fruit nectars are among the foods that must be labeled in accordance with § 102.33. This regulation permits products that traditionally have been considered to be canned fruit nectars to continue to bear the term ''nectar.''

D. Conclusions and Proposal

The agency points out that the stayed standard of identity for canned fruit nectars was established under section 701(e) of the act (21 U.S.C. 371(e)), which required formal rulemaking in any action for the establishment, amendment, or repeal of a food standard. However, the 1990 amendments removed food standards rulemaking proceedings, except for the amendment or repeal of standards of identity for dairy products and maple syrup, from the formal rulemaking requirements of section 701(e) of the act (see section 8 of the 1990 amendments). Therefore, rulemaking proceedings to revise or repeal the stayed standard for canned fruit nectars are subject to section 701(a) of the act.

In considering its options with respect to the stayed standard, the agency considered proposing to amend it to incorporate the revised Brix values as a means of responding to the objections on the canned nectars final rule. FDA rejected this option because the Brix values in the standard would duplicate the provisions in § 101.30. In addition, § 102.33 provides for the use of an appropriately descriptive name for diluted juice beverages, including fruit nectars. FDA believes that use of an appropriately descriptive name, along with a declaration of the percentage of juice, will provide adequate information to consumers regarding the nature of fruit nectars, and that a separate standard of identity for canned fruit nectars is not necessary. Thus, the agency tentatively concludes that the stayed standard of identity for canned fruit nectars should be removed.

The agency's tentative view is supported by the petitioner for the canned fruit nectars standard. In a letter to the agency dated July 8, 1994, and filed under Docket No. 80N–0140, NFPA stated that the opinion of its members is that, with the advent of mandatory percent juice labeling for any food that purports to be a beverage that contains a fruit or vegetable juice (§ 101.30), the stayed standard is no longer necessary and should be removed from the Code of Federal Regulations. Accordingly, NFPA requested that the agency take such action.

Thus, in view of the petitioner's request and of the existing requirements for percent juice declaration in § 101.30 and for naming diluted juice beverages in § 102.33, FDA tentatively concludes that the standard of identity for canned fruit nectars in § 146.113 is not needed, and that no further action on the objections filed to the May 7, 1968, final rule establishing that standard is warranted. Therefore, FDA is proposing to revoke the stayed standard of identity for canned fruit nectars.

II. Economic Impact

As required by Executive Order 12866 and the Regulatory Flexibility Act (Pub. L. 354), FDA has examined the economic implications of this proposed rule that would remove the stayed standard of identity for canned fruit nectars in 21 CFR part 164. Executive Order 12866 directs agencies to assess all costs and benefits of available regulatory alternatives and, when regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health, and safety effects; distributive impacts; and equity). The Regulatory Flexibility Act requires that the agency analyze options for regulatory relief for small businesses.

FDA believes that there will be no economic impact on the juice processing industry from this proposed rule because the removal of the stayed standard will not result in any new costs or requirements. Canned fruit nectars, currently marketed as nonstandardized foods, will continue to be named and labeled in accordance with the existing requirements of §§ 101.30 and 102.33. Removal of the stayed standard will eliminate confusion regarding the compositional requirements for juice products named by use of the term ''nectar.''

Thus, FDA concludes that this is not a significant regulatory action as defined by Executive Order 12866. In compliance with the Regulatory Flexibility Act, the agency certifies that the final rule will not have a significant impact on a substantial number of small businesses.

III. Environmental Impact

The agency has determined under 21 CFR 25.24(b)(1) that this action is of a type that does not individually or cumulatively have a significant effect on the human environment. Therefore, neither an environmental assessment nor an environmental impact statement is required.

IV. Request for Comments

Interested persons may, on or before June 20, 1995, submit to the Dockets Management Branch (address above) written comments regarding this proposal. Two copies of any comments are to be submitted, except that individuals may submit one copy. Comments are to be identified with the docket number found in brackets in the heading of this document. Received comments may be seen in the office above between 9 a.m. and 4 p.m., Monday through Friday.

List of Subjects in 21 CFR Part 146

Food grades and standards, Fruit juices.

Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs, and redelegated to the Director, Center for Food Safety and Applied Nutrition, it is proposed that 21 CFR part 146 be amended as follows:

PART 146—CANNED FRUIT JUICES

1. The authority citation for 21 CFR part 146 continues to read as follows:

Authority: Secs. 201, 401, 403, 409, 701, 721 of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321, 341, 343, 348, 371, 379e).

§ 146.113 [Removed]

2. Section 146.113 *Canned fruit nectars* is removed from subpart B.

Dated: February 8, 1995.

Fred R. Shank,

Director, Center for Food Safety and Applied Nutrition.

[FR Doc. 95–9949 Filed 4–20–95; 8:45 am]

BILLING CODE 4160–01–F

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[IA–18–95]

RIN 1545–AT33

Lease Term; Exchanges of Tax-Exempt Use Property

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the lease term of tax-exempt use property. The proposed regulations also provide guidance regarding certain like-kind exchanges among related parties involving tax-exempt use property. This document also provides notice of a public hearing on these regulations.

DATES: Written comments must be received by July 20, 1995. Requests to appear and outlines of topics to be discussed at the public hearing scheduled for August 2, 1995, must be received by July 12, 1995.

ADDRESSES: Send submissions to: CC:DOM:CORP:T:R (IA–18–95), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:T:R (IA–18–95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. The public hearing will be held in the IRS Auditorium, 7th Floor, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, John M. Aramburu of the Office of Assistant Chief Counsel (Income Tax and Accounting) at (202) 622–4960; concerning submissions and the public hearing, Christian Vasquez, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) relating to the depreciation of tax-exempt use property under section 168 of the Internal Revenue Code (Code). Section 168(h) provides rules relating to the definition of tax-exempt use property. Section 168(i)(3) provides rules for determining a lease term for purposes of section 168. These proposed regulations provide guidance relating to certain exchanges of tax-exempt use property among related parties and the determination of lease term under certain circumstances.

Explanation of Provisions

Current Law

Under section 168, property used in a trade or business, or held for the production of income, generally may be depreciated under the general depreciation system (GDS) using accelerated methods over relatively short recovery periods. However, certain property must be depreciated under the alternative depreciation system (ADS) described in section 168(g). Under ADS, depreciation deductions are determined using the straight-line method over longer recovery periods.

Under section 168(g)(1)(B), tax-exempt use property is subject to ADS. Section 168(h)(1) defines tax-exempt use property to include that portion of any tangible property (other than nonresidential real property) leased to a tax-exempt entity, as well as nonresidential real property, under certain conditions. For these purposes, section 168(h)(2)(A)(iii) provides that certain foreign entities and persons are considered tax-exempt entities. Under ADS, the recovery period of tax-exempt use property subject to a lease is no less than 125 percent of the lease term. See section 168(g)(3)(A).

The intent of Congress is subjecting tax-exempt use property to a slower depreciation system than GDS is expressed in the legislative history as follows:

> The committee believes that reform of the tax law is essential, insofar as it relates to property used by tax-exempt entities under a lease, a lease formulated as a service contract, or other similar arrangements. When tax-exempt entities use property under these arrangements, they pay reduced rents that reflect a pass-through of investment tax incentives from the owner of the property. Tax-exempt entities thereby benefit from investment incentives for which they do not qualify directly, and effectively gain the advantage of taking income tax deductions and credits while having no corresponding liability to pay any tax on income from the property.

S. Rep. No. 169 (Vol. 1), 98th Cong., 2d Sess. 123 (1984).

Thus, Congress subjected tax-exempt use property to a slower depreciation system in order to prevent tax-exempt entities from receiving, through reduced rentals, the tax benefits of GDS. Congress retained the rules for depreciating tax-exempt use property when it modified the accelerated cost recovery system in 1986. S. Rep. No. 313, 99th Cong., 2d Sess. 103 (1986).

Section 168(i)(5) provides that when property changes status, for example, ceases to be tax-exempt use property, the depreciation deduction for the year of change and subsequent taxable years shall be determined in such manner as the Secretary shall prescribe by regulation. Proposed § 1.168–2(j)(3) sets forth principles for depreciating property following a change in its status. Section 1.168(j)–1T, Q&A 2, which relates to tax-exempt use property, references that provision.

The tax-exempt use property rules contain a number of references to lease term. As noted above, the recovery period of tax-exempt use property subject to a lease is no less than 125 percent of the lease term. In addition, section 168(h)(1)(B)(ii)(III) characterizes as tax-exempt use property nonresidential real property leased to a tax-exempt entity for a term in excess of 20 years, section 168(h)(3)(A) excludes from the definition of tax-exempt use property certain high technology equipment leased to a tax-exempt entity for a term of no more than five years, and section 168(h)(1)(C) excludes property subject to certain short-term leases from the tax-exempt use property rules.

For each of these purposes, the lease term is determined under all the facts and circumstances. Further, legislative history states that rules ''similar to those applied under section 46(e)(3) (relating to investment credits for non-corporate lessors) be applied in determining lease term. See. e.g., *Hokanson* v. *Commissioner*, 730 F.2d 1245, 1248 (9th Cir. 1984) (which applies a reasonable expectations test).'' S. Rep. No. 169 (Vol. 1), 98th Cong., 2d Sess. 150 (1984). Section 168(i)(3) provides rules for determining a lease term. It indicates that, in determining a lease term, options to renew generally must be taken into account and the periods of certain successive leases must be aggregated with the period of an original lease.

Section 1.168(j)–1T, Q&A 17, provides additional rules for determining lease term. The regulation sets forth circumstances under which a lease term will include not only the stated duration of a lease but also an additional period, including options to renew and successive leases. It also provides examples of situations in which aggregation of lease periods is required, and situations in which lease periods are considered sufficiently independent so that aggregation is not required.

Lease Term

The proposed regulations generally clarify the rules for determining a lease

term in certain situations. They require the aggregation of the stated duration of an original lease with any additional period for which the original, tax-exempt lessee (or a person related to the lessee) retains financial responsibility. The proposed regulations are intended to supplement existing authorities, including § 1.168(j)–1T, Q&A 17.

Specifically, the proposed regulations provide that an additional period of time during which a lessee may not continue to be the lessee is nevertheless included in the lease term if the lessee (or a related person) has agreed that one or both of them will or could be obligated to make a payment of rent, or a payment in the nature of rent, with respect to such period. For purposes of this rule, a payment in the nature of rent includes a payment intended to substitute for rent or to fund or supplement the rental payments of another. For example, a payment in the nature of rent includes a payment of any kind that is required to be made in the event that: (1) The leased property is not leased for the additional period; (2) the leased property is leased for the additional period under terms that do not satisfy specified terms and conditions; (3) there is a failure to make a payment of rent with respect to such additional period; or (4) similar circumstances occur. This rule disregards, however, obligations to make de minimis payments.

The proposed regulations also provide that in the event an additional period is included in the lease term, section 168(i)(5) (relating to changes in status) applies if the leased property ceases to be tax-exempt use property for such additional period.

The proposed regulations apply to leases entered into on or after the date the proposed regulations are filed with the **Federal Register**. No inference as to the treatment of additional lease periods under current law is intended by such effective date. The proposed regulations do not preclude the application of common law doctrines (such as the substance over form or step transaction doctrines) and other authorities to the determination of lease term or to the determination of whether a transaction is characterized as a lease, a conditional sale, or otherwise for federal income tax purposes.

Like-Kind Exchanges

The proposed regulations also addresses certain transactions between related persons that are designed to circumvent the tax-exempt use property rules. For example, a taxpayer might purchase tax-exempt use property for $100x and then promptly transfer the property to a related person in exchange for like-kind property of an equal value that has a zero basis and is not tax-exempt use property (the taxable property). If the exchange qualifies for nonrecognition treatment under section 1031 as to the related person, the related person recognizes none of its gain with respect to the taxable property and takes the tax-exempt use property with a zero basis. At the same time, the taxpayer has a $100x basis in the taxable property. The desired net tax result of the transaction is that a new investment in property that is properly subject to the ADS becomes subject to GDS.

To address this situation, the proposed regulations provide that property (tainted property) transferred directly or indirectly to the taxpayer by a related person (the related party) as part of, or in connection with, a transaction described in section 1031 where the related party receives tax-exempt use property (related tax-exempt use property) will, if the tainted property is subject to an allowance for depreciation, be treated in the same manner as the related tax-exempt use property for purposes of determining the allowable depreciation deduction under section 167(a). Under this rule, the tainted property is depreciated by the taxpayer over the remaining recovery period of, and using the same depreciation method and convention as that of, the related tax-exempt use property.

This rule is subject to certain limitations. In general, the rule applies only with respect to so much of the taxpayer's basis in the tainted property as does not exceed the taxpayer's adjusted basis in the related tax-exempt use property prior to the transfer. Any excess of the taxpayer's basis in the tainted property over its adjusted basis in the related tax-exempt use property prior to the transfer is treated as property to which the rule does not apply. Moreover, the rule does not apply to so much of the taxpayer's basis in the tainted property as is subject to section 168(i)(7).

The proposed regulations provide that related tax-exempt use property includes property that does not become tax-exempt use property (as defined in section 168(h)) until after the transfer if, at the time of the transfer, it was intended that the property become tax-exempt property. Moreover, in the circumstances described in the preceding sentence, the related tax-exempt use property will be treated as having, prior to the transfer, a lease term equal to the term of any lease that causes such property to become tax-exempt use property.

The proposed regulations only apply with respect to direct or indirect transfers of property involving related persons where (1) section 1031 applies to any party, and (2) a principal purpose of the transfer is to avoid or limit the application of ADS. For purposes of this rule, a person is related to another person if they bear a relationship specified in section 267(b) or section 707(b)(1).

The proposed regulations apply to transfers made on or after the date the proposed regulations are filed with the **Federal Register**. No inference is intended as to the treatment of transfers intended to avoid or limit the application of ADS that are made prior to the effective date. In addition, the proposed regulations do not preclude the application of common law doctrines (such as the substance over form or step transaction doctrines) and other authorities to transfers intended to avoid or limit the application of ADS, including transfers occurring prior to the effective date of the proposed regulations.

The IRS and Treasury invite comments on the scope of the proposed regulations. For example, comments are requested as to whether any transactions should be excepted from the proposed regulations or whether other transactions should be included within their scope.

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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these proposed regulations, and, therefore, a Regulatory Flexibility Analysis 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 businesses.

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 August 2, 1995, at 10 a.m. in the IRS Auditorium, 7th Floor, 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 July 20, 1995 and submit an outline of the topics to be discussed and the time to be devoted to each topic by July 12, 1995.

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 proposed regulations is John M. Aramburu of the Office of Assistant Chief Counsel (Income Tax and Accounting). 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 entries in numerical order to read as follows:

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

Section 1.168(h)–1 also issued under 26 U.S.C. 168.

Section 1.168(i)–2 also issued under 26 U.S.C. 168. * * *

Par. 2. Sections 1.168(h)–1 and 1.168(i)–2 are added to read as follows:

§ 1.168(h)–1 Like-kind exchanges involving tax-exempt use property.

(a) *Scope.* (1) This section applies with respect to a direct or indirect transfer of property among related persons, including transfers made through a qualified intermediary (as defined in § 1.1031(k)–1(g)(4)) or other unrelated person, (a *transfer*) if—

(i) Section 1031 applies to any party to the transfer or to any related transaction; and

(ii) A principal purpose of the transfer or any related transaction is to avoid or limit the application of the alternative depreciation system (within the meaning of section 168(g)).

(2) For purposes of this section, a person is related to another person if they bear a relationship specified in section 267(b) or section 707(b)(1).

(b) *Allowable depreciation deduction for property subject to this section*—(1) *In general.* Property (*tainted property*) transferred directly or indirectly to a taxpayer by a related person (*related party*) as part of, or in connection with, a transaction in which the related party receives tax-exempt use property (*related tax-exempt use property*) will, if the tainted property is subject to an allowance for depreciation, be treated in the same manner as the related tax-exempt use property for purposes of determining the allowable depreciation deduction under section 167(a). Under this paragraph (b), the tainted property is depreciated by the taxpayer over the remaining recovery period of, and using the same depreciation method and convention as that of, the related tax-exempt use property.

(2) *Limitations*—(i) *Taxpayer's basis in related tax-exempt use property.* This section applies only with respect to so much of the taxpayer's basis in the tainted property as does not exceed the taxpayer's adjusted basis in the related tax-exempt use property prior to the transfer. Any excess of the taxpayer's basis in the tainted property over its adjusted basis in the related tax-exempt use property prior to the transfer is treated as property to which this section does not apply. This paragraph (b)(2)(i) does not apply if the related tax-exempt use property is not acquired from the taxpayer (e.g., if the taxpayer acquires the tainted property for cash but section 1031 nevertheless applies to the related party because the transfer involves a qualified intermediary).

(ii) *Application of section 168(i)(7).* This section does not apply to so much of the taxpayer's basis in the tainted property as is subject to section 168(i)(7).

(c) *Related tax-exempt use property.* (1) For purposes of paragraph (b) of this section, related tax-exempt use property includes—

(i) Property that is tax-exempt use property (as defined in section 168(h)) at the time of the transfer; and

(ii) Property that does not become tax-exempt use property until after the transfer if, at the time of the transfer, it was intended that the property become tax-exempt use property.

(2) For purposes of determining the remaining recovery period of the related tax-exempt use property in the circumstances described in paragraph (c)(1)(ii) of this section, the related tax-exempt use property will be treated as having, prior to the transfer, a lease term equal to the term of any lease that causes such property to become tax-exempt use property.

(d) *Examples.* The following examples illustrate the application of this section. The examples do not address common law doctrines or other authorities that may apply to recharacterize or alter the effects of the transactions described therein. Unless otherwise indicated, parties to the transactions are not related to one another.

Example 1. (i) X owns all of the stock of two subsidiaries, B and Z. X, B and Z do not file a consolidated federal income tax return. On May 5, 1995, B purchases an aircraft (*FA*) for $1 million and leases it to a foreign airline whose income is not subject to United States taxation and which is a tax-exempt entity as defined in section 168(h)(2). On the same date, Z owns an aircraft (*DA*) with a fair market value of $1 million, which has been, and continues to be, leased to an airline that is a United States taxpayer. Z's adjusted basis in DA is $0. The next day, at a time when each aircraft is still worth $1 million, B transfers FA to Z (subject to the lease to the foreign airline) in exchange for DA (subject to the lease to the airline that is a United States taxpayer). Z realizes gain of $1 million on the exchange, but that gain is not recognized pursuant to section 1031(a) because the exchange is of like-kind properties. Assume that a principal purpose of the transfer of DA to B or of FA to Z is to avoid the application of the alternative depreciation system. Following the exchange, Z has a $0 basis in FA pursuant to section 1031(d). B has a $1 million basis in DA.

(ii) B has acquired property from Z, a related person; Z's gain is not recognized pursuant to section 1031(a); Z has received tax-exempt use property as part of the transaction; and a principal purpose of the transfer of DA to B or of FA to Z is to avoid the application of the alternative depreciation system. Accordingly, the transaction is within the scope of this section. Pursuant to paragraph (b) of this section, B must recover its $1 million basis in DA over the remaining recovery period of, and using the same depreciation method and convention as that of, FA, the related tax-exempt use property.

(iii) If FA did not become tax-exempt use property until after the exchange, it would still be related tax-exempt use property and paragraph (b) of this section would apply if, at the time of the exchange, it was intended that FA become tax-exempt use property.

Example 2. (i) X owns all of the stock of two subsidiaries, B and Z. X, B and Z do not file a consolidated federal income tax return. B and Z each own identical aircraft. B's aircraft (*FA*) is leased to a tax-exempt entity as defined in section 168(h)(2) and has a fair market value of $1 million and an adjusted basis of $500,000. Z's aircraft (*DA*) is leased to a United States taxpayer and has a fair market value of $1 million and an adjusted basis of $10,000. On May 1, 1995, B and Z exchange aircraft, subject to their respective leases. B realizes gain of $500,000 and Z realizes gain of $990,000, but neither person recognizes gain because of the operation of

section 1031(a). Moreover, assume that a principal purpose of the transfer of DA to B or of FA to Z is to avoid the application of the alternative depreciation system.

(ii) As in example 1, B has acquired property from Z, a related person; Z's gain is not recognized pursuant to section 1031(a); Z has received tax-exempt use property as part of the transaction; and a principal purpose of the transfer of DA to B or of FA to Z is to avoid the application of the alternative depreciation system. Thus, the transaction is within the scope of this section even though B has held tax-exempt use property for a period of time and, during that time, has used the alternative depreciation system with respect to such property. Pursuant to paragraph (b) of this section, B, which has a substituted basis determined pursuant to section 1031(d) of $500,000 in DA, must depreciate the aircraft over the remaining recovery period of FA, using the same depreciation method and convention. Z holds tax-exempt use property with a basis of $10,000, which must be depreciated under the alternative depreciation system.

(iii) Assume the same facts as in paragraph (i) of this example, except that B and Z are members of an affiliated group that files a consolidated federal income tax return. Of B's $500,000 basis in DA, $10,000 is subject to section 168(i)(7) and therefore not subject to this section. The remaining $490,000 of basis is subject to this section.

(e) *Effective date.* This section applies to transfers made on or after April 20, 1995.

§ 1.168(i)–2 Lease term.

(a) *In general.* For purposes of section 168, a lease term is determined under all the facts and circumstances. Paragraph (b) of this section and § 1.168(j)–1T, Q&A 17, provide rules that apply to determine whether a period of time not included in the stated duration of an original lease (*additional period*) is included in the lease term, under certain circumstances. These rules do not prevent the inclusion of an additional period in the lease term in other circumstances.

(b) *Lessee retains financial obligation.* (1) An additional period of time during which a lessee may not continue to be the lessee will nevertheless be included in the lease term if the lessee (or a related person) has agreed that one or both of them will or could be obligated to make a payment of rent or a payment in the nature of rent with respect to such period.

(2) For the purposes of this paragraph (b), a payment in the nature of rent includes a payment intended to substitute for rent or to fund or supplement the rental payments of another. For example, a payment in the nature of rent includes a payment of any kind that is required to be made in the event that—

(i) The leased property is not leased for the additional period;

(ii) The leased property is leased for the additional period under terms that do not satisfy specified terms and conditions;

(iii) There is a failure to make a payment of rent with respect to such additional period; or

(iv) Circumstances similar to those described in paragraph (b)(2)(i), (ii), or (iii) occur.

(3) For the purposes of this paragraph (b), de minimis payments will be disregarded.

(c) *Related person.* For purposes of paragraph (b) of this section, a person is related to the lessee if such person is described in section 168(h)(4).

(d) *Changes in status.* Section 168(i)(5) (changes in status) applies if an additional period is included in a lease term under this section and the leased property ceases to be tax-exempt use property for such additional period.

(e) *Example.* The following example illustrates the application of this section. The example does not address common law doctrines or other authorities that may apply to cause an additional period to be included in the lease term or to recharacterize a lease as a conditional sale or otherwise for federal income tax purposes. Unless otherwise indicated, parties to the transactions are not related to one another.

Example. Financial obligation with respect to an additional period.—(i) *Facts.* X, a taxable corporation, and Y, a foreign airline whose income is not subject to United States taxation, enter into a lease agreement under which X agrees to lease an aircraft to Y for a period of 10 years. The lease agreement provides that, at the end of the lease period, Y is obligated to find a subsequent lessee (*replacement lessee*) to enter into a subsequent lease (*replacement lease*) of the aircraft from X for an additional 10-year period. The provisions of the lease agreement require that any replacement lessee be unrelated to Y and that it not be a tax-exempt entity as defined in section 168(h)(2). The provisions of the lease agreement also set forth the basic terms and conditions of the replacement lease, including its duration and the required rental payments. In the event Y fails to secure a replacement lease, the lease agreement requires Y to make a payment to X in an amount determined under the lease agreement.

(ii) *Application of this section.* The lease agreement between X and Y obligates Y to make a payment in the event the aircraft is not leased for the period commencing after the initial 10-year lease period and ending on the date the replacement lease is scheduled to end. Accordingly, pursuant to paragraph (b) of this section, the term of the lease between X and Y includes such additional period, and the lease term is 20 years for purposes of section 168.

(ii) *Facts modified.* Assume the same facts as in paragraph (i) of this example, except that Y is required to guarantee the payment of rentals under the 10-year replacement lease and to make a payment to X equal to the present value of any excess of the replacement lease rental payments specified in the lease agreement between X and Y, over the rental payments actually agreed to be paid by the replacement lessee. Pursuant to paragraph (b) of this section, the term of the lease between X and Y includes the additional period, and the lease term is 20 years for purposes of section 168.

(iv) *Changes in status.* If, upon the conclusion of the stated duration of the lease between X and Y, the aircraft either is returned to X or leased to a replacement lessee that is not a tax-exempt entity as defined in section 168(h)(2), the subsequent method of depreciation will be determined pursuant to section 168(i)(5).

(f) *Effective date.* This section applies to leases entered into on or after April 20, 1995.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

[FR Doc. 95–9946 Filed 4–20–95; 8:45 am]

BILLING CODE 4830–01–M

DEPARTMENT OF JUSTICE

28 CFR Part 16

[AAG/A Order No. 102–95]

Exemption of Records System Under the Privacy Act

AGENCY: Department of Justice.

ACTION: Proposed rule.

SUMMARY: The Department of Justice, Bureau of Prisons (BOP), proposes to exempt a Privacy Act system of records from subsections (c)(3) and (4), (d), (e)(2) and (3), (e)(5) and (8), (f) and (g) of the Privacy Act, 5 U.S.C. 552a(j)(2) and (k)(2). This system of records is the BOP ''Telephone Activity Record System (JUSTICE/BOP–011).'' Information in this system relates to inmate telephone activity and may include information relating to official Federal investigations and matters of law enforcement of the BOP pursuant to 18 U.S.C. 2510 *et seq.*, 3621, 4003, 4042 and 4082. The exemptions are necessary to protect third party privacy and to avoid interference with law enforcement activities, e.g., to preclude the disclosure of investigative techniques, to prevent subjects of investigations from frustrating the investigative process, and to more effectively ensure the safety, security and good order of Federal correctional facilities.

DATES: Submit any comments by May 22, 1995.