against airlines that code-share, or deny access to airlines that code-share, because code-sharing has become a widespread practice since the Board adopted the rules and travel agents and airlines should have some ability to keep systems from discriminating against code-share services. 70 FR 16994. We invited interested persons to submit comments on these findings under the Regulatory Flexibility Act. No one submitted comments on our reasoning.

The Regulatory Flexibility Act requires us to publish a final regulatory flexibility analysis that considers such matters as the impact of a rule on small entities if the rule would have ''a significant economic impact on a substantial number of small entities.'' 5 U.S.C. 605(b). For the reasons stated above, I certify that the elimination of our rule on the treatment of code-share operations will not have a significant economic impact on a substantial number of small entities. No final regulatory flexibility analysis is therefore required for this action.

Our final rule contains no direct reporting, recordkeeping, or other compliance requirements that would affect small entities. There are no other federal rules that duplicate, overlap, or conflict with our proposed rules.

Assistance for Small Entities

Under section 213(a) of the Small Business Regulatory Enforcement Fairness Act of 1996, Public Law 104–121, we want to assist small entities in understanding the proposed rule so that they can better evaluate its effects on them and participate in the rulemaking. If the final rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please consult Thomas Ray at (202) 366–4731.

Paperwork Reduction Act

The final rule contains no collection-of-information requirements subject to the Paperwork Reduction Act, Public Law 96–511, 44 U.S.C. Chapter 35. *See* 57 FR at 43834.

Federalism Implications

Our final rule will have no substantial direct effects on the States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, in accordance with Executive Order 13132, dated August 4, 1999, we have determined that it does not present sufficient federalism implications to warrant consultations with State and local governments.

Taking of Private Property

This rule will not effect a taking of private property or otherwise have taking implications under Executive Order 12630, Government Actions and Interference with Constitutionally Protected Property Rights.

Civil Justice Reform

This rule meets applicable standards in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

Protection of Children

We have analyzed this rule under Executive Order 13045, Protection of Children from Environmental Heath Risks and Safety Risks. This rule does not concern an environmental risk to health or risk to safety that may disproportionately affect children.

Consultation and Coordination With Tribal Governments

This rule will not have tribal implications, will not impose substantial direct compliance costs on Indian tribal governments, and will not preempt tribal law. Therefore, it is exempt from the consultation requirements of Executive Order 13175. No tribal implications were identified during the comment period.

Energy Effects

We have analyzed this rule under Executive Order 13211, Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use. We have determined that this is not classified as a ''significant energy action'' under that order because it is a ''significant regulatory action'' under Executive Order 12866 and it would not have a significant adverse effect on the supply, distribution, or use of energy.

Environment

This rule will have no significant impact on the environment.

List of Subjects in 14 CFR Part 256

Air carriers, Antitrust.

PART 256—[REMOVED AND RESERVED]

■ Accordingly the Department removes and reserves 14 CFR part 256.

Issued in Washington, DC, on February 8, 2006.

Norman Y. Mineta,

Secretary of Transportation.

[FR Doc. 06–1550 Filed 2–17–06; 8:45 am]

BILLING CODE 4910–62–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9250]

RIN 1545–BD46

Application of Section 367 in Cross Border Section 304 Transactions; Certain Transfers of Stock Involving Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that address the interaction of section 304 and section 367. These regulations provide that section 367(a) and (b) do not apply to a deemed section 351 exchange resulting from a section 304(a)(1) transaction. These regulations may apply to taxpayers transferring stock to related foreign corporations.

DATES: *Effective Date:* This regulation is effective February 21, 2006.

Applicability Dates: For dates of applicability, see § 1.367(a)–3(e)(1)(G) and § 1.367(b)–6(a)(1).

FOR FURTHER INFORMATION CONTACT: Tasheaya L. Warren Ellison, (202) 622–3870 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

On May 25, 2005, the IRS and Treasury published in the **Federal Register** a notice of proposed rulemaking (REG–127740–04; 2005–24 I.R.B. 1254; [70 FR 30036]) under section 367(a) and (b) of the Internal Revenue Code (proposed regulations) pursuant to the regulatory authority under section 367. The proposed regulations would provide that if, pursuant to section 304(a)(1), a U.S person is treated as transferring stock of a domestic or foreign corporation to a foreign corporation in exchange for stock of such foreign corporation in a transaction to which section 351(a) applies, such deemed section 351 exchange is not a transfer to a foreign corporation subject to section 367(a). The proposed regulations would further provide that if, pursuant to section

304(a)(1), a foreign corporation is treated as acquiring the stock of another foreign corporation in a transaction to which section 351(a) applies, such deemed section 351 exchange is not an acquisition subject to section 367(b).

A public hearing was not held with respect to the proposed regulations because no requests to speak were received. However, several written comments were received.

After consideration of the comments, the proposed regulations are adopted, as revised by this Treasury decision. The comments received and the revisions are discussed below.

Explanation of Provisions and Summary of Comments

A. Nonapplication of Section 367(a) and (b) to Deemed Section 351 Exchanges

Section 304(a)(1) generally provides that, for purposes of sections 302 and 303, if one or more persons are in control of each of two corporations and in return for property one of the corporations (the acquiring corporation) acquires stock in the other corporation (the issuing corporation) from the person (or persons) so in control, then such property shall be treated as a distribution in redemption of the acquiring corporation stock. To the extent the distribution is treated as a distribution to which section 301 applies, the transferor and the acquiring corporation are treated as if (1) the transferor transferred the stock of the issuing corporation to the acquiring corporation in exchange for stock of the acquiring corporation in a transaction to which section 351(a) applies, and (2) the acquiring corporation then redeemed the stock it is treated as having issued. Under section 301(c)(1), the distribution is first treated as a dividend to the extent of certain earnings and profits of the acquiring corporation and the issuing corporation. See sections 316 and 304(b). Then under section 301(c)(2) and (3), the remaining portion of the distribution is applied against and reduces the adjusted basis of the stock, and finally is treated as gain from the sale or exchange of property.

Section 367(a)(1) provides that if, in connection with certain nonrecognition transactions, including section 351, a United States person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. In addition, certain section 351 exchanges can cause the exchanging shareholder to include in income a deemed dividend under section 367(b). § 1.367(b)–4.

Under current law, certain section 304(a)(1) transactions can also be subject to section 367. The result of this overlapping application is considerable complexity, uncertainty, and the risk of multiple income inclusions. In such a transaction, a U.S. person could recognize income (dividend or capital gain) equal to the built-in gain in the stock of the issuing corporation under section 367, and income (dividend or capital gain) pursuant to section 304. The total income recognized could exceed the fair market value of the transferred stock of the issuing corporation.

The proposed regulations would exclude from the application of sections 367(a) and (b) a deemed section 351 exchange that arises by reason of a transaction described in section 304(a)(1). The IRS and the Treasury believe that the interests of the government are protected, and the policies underlying section 367(a) and (b) are preserved, in a section 304(a)(1) transaction without regard to the application of section 367. The IRS and Treasury believe that, in most or all cases, the income recognized in a section 304 transaction will equal or exceed the transferor's inherent gain in the stock of the issuing corporation transferred to the foreign acquiring corporation. Elimination of the application of section 367(a) and (b) in this context will also serve the interests of sound tax administration by creating greater certainty and simplicity in these transactions, and by avoiding the over-inclusion of income that could result when section 367 and section 304 both apply to such transactions. As a result, this Treasury decision finalizes the proposed regulations and makes section 367(a) and (b) inapplicable to deemed section 351 exchanges pursuant to section 304(a)(1) transactions.

Commentators did note that in certain cases, depending on how the basis and distribution rules are applied, the amount of income recognized under section 304(a) may not equal or exceed the transferor's inherent gain in the stock of the issuing corporation. In the example cited, P, a domestic corporation, owns all the stock of F1 and F2, both of which are foreign corporations. P has an adjusted basis of $0 in its F1 stock and $100x in its F2 stock. P's stock of F1 and F2 each has a fair market value of $100x. Neither F1 nor F2 has current or accumulated earnings and profits. P sells its F1 stock to F2 for its fair market value of $100x in a transaction subject to section 304(a)(1). Under section 304(a)(1), the transaction is treated as if P had transferred its F1 stock to F2 in exchange for F2 stock in a transaction to which section 351(a) applies, and then F2 had redeemed such deemed issued stock.

These commentators posit that P in the above example may not recognize income or gain because the adjusted basis of both the F2 stock that is treated as being issued in the deemed section 351 exchange, and the adjusted basis of the F2 stock already held by P prior to the transaction, is available for reduction under section 301(c)(2). On these particular facts (i.e., no earnings and profits in either the acquiring corporation or the issuing corporation), this basis position would mean that income or gain is not recognized as a result of the transaction. The IRS and the Treasury believe, however, that current law does not provide for the recovery of the basis of any shares other than the basis of the F2 stock deemed to be received by P in the section 351(a) exchange (which would take a basis equal to P's basis in the F1 stock). Thus, in the case described, P would recognize $100x of gain under section 301(c)(3) (the built-in gain on the F1 stock), and P would continue to have a $100x basis in its F2 stock that it holds after the transaction. This issue will be addressed as part of a larger project regarding the recovery of basis in all redemptions treated as section 301 distributions. This larger project will be the subject of future guidance. Comments are requested about the appropriate treatment of basis in such redemptions.

B. Adjustments Under Section 304(b)(6)

Section 304(b)(6) provides that in the case of any acquisition to which section 304(a) applies, where the acquiring or issuing corporation is a foreign corporation, the Secretary shall prescribe regulations, as appropriate, in order to eliminate a multiple inclusion of any item in income and to provide appropriate basis adjustments (including modifications to the application of sections 959 and 961). The preamble to the proposed regulations requested comments on basis adjustments under section 304(b)(6). The preamble also requested comments regarding similar adjustments that could be made outside the context of section 304(b)(6).

Several comments were received in response to this request, and will be considered in a separate guidance project. The IRS and Treasury request additional comments on section 304(b)(6), particularly comments that would take into account the effect of section 362(e), enacted on October 22, 2004, by the American Jobs Creation Act of 2004 (Pub. L. 108–357).

Comments also were received regarding the application of section 959 to previously taxed amounts in connection with section 304(a)(1) transactions. These comments are being considered in a separate guidance project under section 959, and therefore are not addressed in these final regulations.

C. Transfer of Issuing Stock in Return for Property and Stock of Acquiring

The proposed regulations would apply to exclude a section 351 exchange from the application of section 367(a) only to the extent the exchange is treated as such by reason of section 304(a)(1). Thus, section 367(a) would continue to apply to applicable transfers of property subject to section 351 by reason other than the operation of section 304(a)(1).

One commentator notes that the proposed regulations would not address the treatment of stock sales for an amount less than the fair market value of the transferred stock where the acquiring corporation would be deemed to issue stock to the transferor other than as a result of the application of section 304(a)(1). See, for example, section 367(c)(2). The commentator states that in such a case the transfer would be, in part, a section 304(a)(1) transaction and, in part, a section 351(a) exchange (other than by reason of section 304(a)(1)). The commentator requests guidance on such transactions, including, for example, whether such a transaction would be bifurcated and, if so, how the basis in the transferred stock would be allocated between the two parts of the transaction. The same bifurcation and related issues occur in section 304(a)(1) transactions where the acquiring corporation actually issues its own stock in partial consideration for the stock of the issuing corporation.

As was the case with the proposed regulations, these final regulations only apply to the extent of deemed section 351 exchanges resulting from section 304(a)(1) transactions. In addition, these regulations could apply to certain transactions that are, in part, still subject to the stock transfer rules of section 367(a) (*e.g.*, a section 304(a)(1) transaction in which both acquiring stock and property are used as consideration). The issues raised by this commentator are relevant to a wide range of transactions, and are not limited to section 304 transactions that are subject to these regulations. As a result, the IRS and Treasury believe that the resolution of these issues is beyond the scope of this project, and this comment is not addressed in these final regulations.

D. Effective Dates

The proposed regulations stated that the rules would apply to section 304(a)(1) transactions occurring on or after the date of publication of the regulations in the **Federal Register**. Several commentators requested that the final regulations be made retroactive at the election of the taxpayer.

These final regulations adopt the general effective date contained in the proposed regulations and therefore apply to section 304(a)(1) transactions occurring on or after February 21, 2006. In response to the comments received, however, the final regulations provide that taxpayers may rely on the final regulations for all (but not less than all) section 304(a)(1) transactions that occurred in all their open tax years; in such cases, any gain recognition agreements filed pursuant to § 1.367(a)–8 with respect to such transactions shall terminate and have no further effect.

Effect on Other Documents

Rev. Rul. 91–5 (1991–1 C.B. 114) and Rev. Rul. 92–86 (1992–2 C.B. 199) are modified to the extent inconsistent with these regulations.

Special Analyses

The IRS and the Treasury have determined that the adoption of these regulations is not a significant regulatory action as defined in Executive Order 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 these regulations and because these regulations do not impose a collection of information on small entities, a Regulatory Flexibility Analysis under 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 was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Tasheaya L. Warren Ellison, Office of the Associate Chief Counsel (International). However, 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.

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 1.367(a)–3 is amended as follows:

■ 1. A sentence is added to paragraph (a) immediately following the second sentence.

■ 2. The new fourth sentence of paragraph (a) is amended by removing the language ''However'' and adding ''In addition'' in its place.

■ 3. Adding new paragraph (e)(1)(G).

The additions read as follows:

§ 1.367(a)–3 Treatment of transfers of stock or securities to foreign corporations.

(a) *In general.* * * * However, if, pursuant to section 304(a)(1), a U.S. person is treated as transferring stock of a domestic or foreign corporation to a foreign corporation in exchange for stock of such foreign corporation in a transaction to which section 351(a) applies, such deemed section 351 exchange is not a transfer to a foreign corporation subject to section 367(a). * * *

* * * * *

(e) * * * (1) * * *

(G) Except as otherwise provided in this paragraph (e)(1)(G), the third sentence of paragraph (a) of this section shall apply to section 304(a)(1) transactions occurring on or after February 21, 2006. However, taxpayers may rely on the third sentence of paragraph (a) of this section for all section 304(a)(1) transactions occurring in open tax years; in such cases any gain recognition agreements filed pursuant to § 1.367(a)–8 with respect to such transactions shall terminate and have no further effect.

* * * * *

■ **Par. 3.** In § 1.367(b)–4, a sentence is added to paragraph (a) immediately following the first sentence to read as follows:

§ 1.367(b)–4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions.

(a) *Scope.* * * * However, if pursuant to section 304(a)(1), a foreign acquiring corporation is treated as acquiring the stock of a foreign acquired corporation in a transaction to which section 351(a) applies, such deemed section 351 exchange is not an acquisition subject to section 367(b). * * *

* * * * *

■ **Par. 4.** In § 1.367(b)–6, paragraph (a)(1) is amended by adding a sentence to the end to read as follows:

§ 1.367(b)–6 Effective dates and coordination rule

(a) *Effective date*—(1) *In general.* * * * The second sentence of paragraph (a) in § 1.367(b)–4 shall apply to section 304(a)(1) transactions occurring on or after February 21, 2006; however, taxpayers may rely on this sentence for all section 304(a)(1) transactions occurring in open tax years.

* * * * *

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

Approved: February 8, 2006.

Eric Solomon,

Acting Deputy Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 06–1465 Filed 2–17–06; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF JUSTICE

28 CFR Part 16

[AAG/A Order No. 004–2006]

Privacy Act of 1974; Implementation

AGENCY: Department of Justice.

ACTION: Final rule.

SUMMARY: The Department of Justice, Bureau of Prisons (Bureau or BOP), is exempting a Privacy Act system of records from the following subsections of the Privacy Act: (c)(3) and (4), (d)(1)–(4), (e)(2) and (3), (e)(5), and (g). This system of records is the ''Inmate Electronic Message Record System, (JUSTICE/BOP–013).''

The exemptions are necessary to preclude the compromise of institution security, to better ensure the safety of inmates, Bureau personnel and the public, to better protect third party privacy, to protect law enforcement and investigatory information, and/or to otherwise ensure the effective performance of the Bureau's law enforcement functions.

DATES: This final rule is effective February 21, 2006.

FOR FURTHER INFORMATION CONTACT: Mary Cahill, (202) 307–1823.

SUPPLEMENTARY INFORMATION: On November 16, 2005 (70 FR 69487), a proposed rule was published in the **Federal Register** with an invitation to comment. No comments were received.

This rule relates to individuals rather than small business entities. Nevertheless, pursuant to the requirements of the Regulatory Flexibility Act, 5 U.S.C. 601–612, this rule will not have a significant economic impact on a substantial number of small entities.

List of Subjects in 28 CFR Part 16

Administrative Practices and Procedure, Freedom of Information Act, Government in the Sunshine Act, and Privacy Act.

■ Pursuant to the authority vested in the Attorney General by 5 U.S.C. 552a and delegated to me by Attorney General Order No. 793–78, 28 CFR part 16 is amended as follows:

PART 16—PRODUCTION OR DISCLOSURE OF MATERIAL OR INFORMATION

■ 1. The authority for part 16 continues to read as follows:

Authority: 5 U.S.C. 301, 552, 552a, 552b(g) and 553; 18 U.S.C. 4203(a)(1); 28 U.S.C. 509, 510, 534; 31 U.S.C. 3717 and 9701.

■ 2. Section 16.97 is amended by adding paragraphs (p) and (q) to read as follows:

§ 16.97 Exemption of Bureau of Prisons Systems—limited access.

* * * * *

(p) The following system of records is exempt from 5 U.S.C. 552a (c)(3) and (4), (d)(1)–(4), (e)(2) and (3), (e)(5), and (g):

Inmate Electronic Message Record System (JUSTICE /BOP–013).

(q) These exemptions apply only to the extent that information in this system is subject to exemption pursuant to 5 U.S.C. 552a (j)(2) and/or (k)(2). Where compliance would not appear to interfere with or adversely affect the law enforcement process, and/or where it may be appropriate to permit individuals to contest the accuracy of the information collected, the applicable exemption may be waived, either partially or totally, by the BOP. Exemptions from the particular subsections are justified for the following reasons:

(1) From subsection (c)(3) to the extent that this system of records is exempt from subsection (d), and for such reasons as those cited for subsection (d) in paragraph (q)(3) below.

(2) From subsection (c)(4) to the extent that exemption from subsection (d) makes this exemption inapplicable.

(3) From the access provisions of subsection (d) because exemption from this subsection is essential to prevent access of information by record subjects that may invade third party privacy; frustrate the investigative process; jeopardize the legitimate correctional interests of safety, security and good order to prison facilities; or otherwise compromise, impede, or interfere with BOP or other law enforcement agency activities.

(4) From the amendment provisions of subsection (d) because amendment of the records may interfere with law enforcement operations and would impose an impossible administrative burden by requiring that, in addition to efforts to ensure accuracy so as to withstand possible judicial scrutiny, it would require that law enforcement information be continuously reexamined, even where the information may have been collected from the record subject. Also, some of these records come from other Federal criminal justice agencies or State, local and foreign jurisdictions, or from Federal and State probation and judicial offices, and it is administratively impossible to ensure that records comply with this provision.

(5) From subsection (e)(2) because the nature of criminal and other investigative activities is such that vital information about an individual can be obtained from other persons who are familiar with such individual and his/her activities. In such investigations it is not feasible to rely solely upon information furnished by the individual concerning his/her own activities since it may result in inaccurate information and compromise ongoing criminal investigations or correctional management decisions.

(6) From subsection (e)(3) because in view of BOP's operational responsibilities, application of this provision to the collection of information is inappropriate. Application of this provision could provide the subject with substantial information which may in fact impede the information gathering process or compromise ongoing criminal investigations or correctional management decisions.

(7) From subsection (e)(5) because in the collection and maintenance of information for law enforcement purposes, it is impossible to determine in advance what information is accurate, relevant, timely and complete. Material which may seem unrelated, irrelevant or incomplete when collected may take on added meaning or significance at a later date or as an investigation progresses. Also, some of these records may come from other Federal, State, local and foreign law