

entered into, also gives rise to investment-type property if a principal purpose for prepaying is to receive an investment return from the time the prepayment is made until the time payment otherwise would be made. A prepayment does not give rise to investment-type property if—

(A) The primary purpose for the prepayment is to accomplish one or more substantial business purposes that—

(1) Are unrelated to any investment return based on the time value of money; and

(2) Cannot be accomplished without the prepayment;

(B) Prepayments on substantially the same terms are made by a substantial percentage of persons who are similarly situated to the issuer but who are not beneficiaries of tax-exempt financing;

(C) The prepayment is made within 90 days of the date of delivery to the issuer of all of the property or services for which the prepayment is made; or

(D) The prepayment meets the requirements of paragraph (e)(2)(ii) of this section.

(ii) *Certain prepayments to acquire a supply of natural gas.*

(A) *In general.* A prepayment meets the requirements of this paragraph (e)(2)(ii) if—

(1) It is made by or for one or more utilities that are owned by a governmental person, as defined in § 1.141-1(b) (*municipal utility*), to purchase a supply of natural gas; and

(2) At least 95 percent of the natural gas purchased with the prepayment is to be consumed by retail gas customers in the service area (as defined in paragraph (e)(2)(ii)(B) of this section) of a municipal utility, or used to produce electricity that will be furnished to retail electric customers that a municipal utility is obligated to serve under state or Federal law. An obligation that arises solely by reason of a contract is not an obligation to serve under state or Federal law.

(B) *Service area.* For purposes of paragraph (e)(2)(ii)(A)(2) of this section, the service area of a municipal utility shall consist of—

(1) Any area throughout which the municipal utility provided (at all times during the 5-year period ending on the issue date) gas transmission or distribution service, and any area that is contiguous to such an area; or

(2) Any area where the municipal utility is obligated under state or Federal law to provide gas distribution services as provided in such law.

(C) *Commodity swaps.* A prepayment does not fail to meet the requirements of this paragraph (e)(2)(ii) by reason of

any commodity swap contract that may be entered into between the issuer and an unrelated party (other than the gas supplier), or between the gas supplier and an unrelated party (other than the issuer), so long as each swap contract is an independent contract. A swap contract is an independent contract if the obligation of each party to perform under the swap contract is not dependent on performance by any person (other than the other party to the swap contract) under another contract (for example, a gas supply contract or another swap contract).

(iii) *Additional prepayments as permitted by the Commissioner.*

The Commissioner may, by published guidance, set forth additional circumstances in which a prepayment does not give rise to investment-type property.

(iv) *Examples.* The following examples illustrate the application of this paragraph (e)(2):

Example 1. Prepayment after contract is executed. In 1998, City A enters into a ten-year contract with Company Y. Under the contract, Company Y is to provide services to City A over the term of the contract and in return City A will pay Company Y for its services as they are provided. In 2004, City A issues bonds to finance a lump sum payment to Company Y in satisfaction of City A's obligation to pay for Company Y's services to be provided over the remaining term of the contract. The use of bond proceeds to make the lump sum payment constitutes a prepayment for services under paragraph (e)(2)(i) of this section, even though the payment is made after the date that the contract is executed.

Example 2. Prepayment necessary to accomplish substantial business purpose. Authority is a governmental unit that furnishes electricity to the general public. In 1995, Authority enters into a 15-year agreement (the Agreement) with Power Company to obtain certain of its power requirements. In 2003, Authority enters into another contract (the Purchase Contract) with Power Company to obtain a specified amount of additional firm power through 2013. The rates paid by Authority under the Purchase Contract are based on a fixed capacity charge, which reflects Power Company's average cost of certain plants and equipment, and a variable energy charge, which reflects Power Company's average system energy costs to operate the utility, primarily fuel costs. Simultaneously with entering into the Purchase Contract, Authority issues a \$30 million issue with a 6 percent yield and uses the proceeds to make a lump sum payment to Power Company to prepay for the entire fixed capacity charge under the Purchase Contract. Authority pays the variable energy charges as energy is actually delivered. Power Company reports the lump sum payment for Federal tax purposes as income from the sale of capacity. Power Company also agrees to certain concessions under the Agreement, including the elimination of

floors on capacity charges and a moratorium on capacity charge increases for five years. The discount rate used to compute the amount of the prepayment is 18 percent, compounded semi-annually. Power Company's taxable borrowing rate for a loan of a comparable size to the prepayment, with a term that coincides with the term of the Purchase Contract, is 8 percent, compounded semiannually. The prepayment allows Power Company to offer a low capacity charge to Authority, yet prevent other wholesale customers from taking advantage of the proposal. Under Federal rate-making guidelines, if Power Company had offered Authority a contract based on fixed periodic capacity charges, Power Company would have been obligated to offer the same capacity charges to its other wholesale customers (which would have been expected to accept the offer). Power Company is willing to offer Authority the lower capacity charge and to make the other concessions because it owns surplus generating capacity. Thus, it is important to Power Company to maintain its customer base. The loss of a significant customer such as Authority would require that Power Company either succeed in obtaining regulatory authorization to increase its rates charged to other customers or suffer a diminished return on capital. Power Company will not build additional generating facilities directly or indirectly by reason of its obligations under the Purchase Contract, and at the time it entered into the Purchase Contract, it had already incurred capital costs of facilities, which, if allocated to Authority's demands for energy under the Purchase Contract, would exceed the up-front capacity charge. Under paragraph (e)(2)(i)(A) of this section, the prepayment does not give rise to investment-type property.

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Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[REG-104762-00]

RIN 1545-AX89

Levy Restrictions During Installment Agreements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to restrictions on levy during the period that an installment agreement is proposed or in effect. The proposed regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998.

DATE: Written or electronically generated comments and requests for a public hearing must be received by July 16, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-104762-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG-104762-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at www.irs.gov/regs.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Frederick W. Schindler, (202) 622-3620; concerning submissions of comments or requests for a hearing Treena Garret, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) under section 6331 of the Internal Revenue Code (Code). The proposed regulations reflect the amendment of section 6331 by section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 Public Law, 105-206, (112 Stat. 685, 764) (RRA 1998). New subsection 6331(k) codifies the IRS practice of withholding collection during consideration of a taxpayer's offer to compromise and extends that practice to proposed installment agreements. The proposed regulations deal principally with the effect of subsection 6331(k) when an installment agreement has been proposed and is pending, is in effect, or has been rejected or terminated.

Prior to the enactment of RRA 1998, the IRS had a long-standing practice of staying action to collect a liability while an offer to compromise that liability was being evaluated and considered, unless the interests of the United States would be jeopardized by doing so. See Policy Statement P-5-97 (Approved July 10, 1959), reprinted at IRM 1.5.17. To insure that the interests of the United States would not be jeopardized while collection was withheld, the IRS required that taxpayers execute a waiver of the statute of limitations for collection of the liabilities the taxpayer was attempting to compromise.

Section 3462 of RRA 1998 added subsection 6331(k) to the Code. Paragraph (1) of the new subsection

codifies the IRS policy of withholding collection during the pendency of an offer to compromise by prohibiting levy while an offer to compromise is pending, for thirty days after a rejection, and during any appeal of that rejection. Temporary regulations published in the **Federal Register** on July 21, 1999, contained provisions governing the effects of subsection 6331(k) when taxpayers submit offers to compromise. See § 301.7122-1T.

Prior to RRA 1998, the IRS did not stay collection when a taxpayer submitted an offer of an installment agreement. Because installment agreements provide for the full payment of the tax liabilities at issue, the processing of requests for installment agreements is less formal and most requests were accepted or rejected within several days of receipt. Once an installment agreement took effect, regulations prohibited levy, as well as certain other enforced collection measures, unless the installment agreement provided otherwise. See § 301.6159-1(d).

Paragraph 6331(k)(2) prohibits levy while a taxpayer's proposal of an installment agreement is pending with the IRS, for thirty days after rejection of such a proposal, while an installment agreement is in effect, for thirty days after termination of an installment agreement by the IRS, and during a timely filed appeal by the taxpayer to the IRS Office of Appeals of a rejection or termination decision.

Paragraph 6331(k)(3) provides that "rules similar to" those contained in paragraphs (3), (4), and (5) of subsection 6331(i) shall apply generally for the purposes of subsection 6331(k). Subsection 6331(i) governs the prohibition on levy during the pendency of a proceeding for refund of a divisible tax. The cross-referenced provisions provide exceptions to the prohibitions on levy, prohibit the initiation by the IRS of court proceedings to collect while the refund proceeding is pending, and provide that the statute of limitations for collection is suspended while levy is prohibited.

The proposed regulations implement the provisions of subsection 6331(k) as they relate to installment agreements. In addition to setting forth the periods during which levy is prohibited, they adapt the rules of paragraphs (3), (4), and (5) of subsection 6331(i) in a manner tailored to the installment agreement process. The legislative history accompanying RRA 1998 explains that Congress did not intend that levy would be prohibited if the IRS determined that an offer to compromise was submitted solely to delay

collection. H.R. Conf. Rep. No. 509, 105th Cong., 2d Sess. 288 (1998). Because the legislative history indicates that Congress intended the same restrictions on levy with respect to offers in compromise be applicable to installment agreements, these proposed regulations adopt the same rule with respect to proposed installment agreements that are submitted solely to delay collection.

Explanation of Provisions

The proposed regulations provide that, subject to certain exceptions, the IRS may not levy to collect a liability while a proposal to enter into an installment agreement for payment of that liability is pending, for thirty days after rejection of such a proposal, while an installment agreement is in effect, for thirty days after termination of an installment agreement by the IRS, and during a timely filed appeal of a rejection or termination by the IRS. A proposed installment agreement is considered pending when it is accepted for processing by the IRS, and remains pending until the IRS accepts or rejects it or the taxpayer withdraws the proposal. If a proposed installment agreement does not contain sufficient information for the IRS to determine whether the proposal should be accepted, the IRS will request the additional necessary information from the taxpayer and provide a reasonable time period for the taxpayer to respond. The IRS may reject the proposed installment agreement if the requested information is not provided.

Collection by levy is not prohibited if the taxpayer waives the restriction on levy in writing, if the IRS determines that the proposed installment agreement was submitted solely to delay collection, or if the IRS determines that collection of the tax liability is in jeopardy.

The proposed regulations provide that the IRS may take actions other than levy to protect the interests of the United States with respect to collection of the liability to which an installment agreement or proposed installment agreement relates. Those actions include, but are not limited to: crediting an overpayment against the liability pursuant to section 6402, filing or refiling notices of Federal tax lien, and taking action to collect from persons liable for the tax but not named in the installment agreement.

Under the proposed regulations, the IRS cannot institute a court proceeding against the taxpayer named in the installment agreement to collect the tax covered by the installment agreement. The IRS, however, may file a claim in

any bankruptcy proceeding, insolvency action, or interpleader case commenced by other creditors of the taxpayer. The IRS also may join the taxpayer in any suit instituted by or against another person liable for payment of the same liability—i.e., in situations where the liability for the tax may be established or disputed. Such proceedings may involve taxes for which more than one person may be jointly and severally liable for the same tax, or may involve persons liable for related liabilities, such as a trust fund recovery penalty under section 6672 or a personal liability for excise tax under section 4103.

While an installment agreement allows the IRS to accept the payment of tax in installments, the agreement does not conclusively establish the taxpayer's liability. A taxpayer therefore is not prohibited from seeking a refund of taxes paid pursuant to an installment agreement. Allowing the IRS to join the taxpayer in a proceeding where the liability for the tax may be established or disputed will protect the Government from having to litigate the same tax in multiple forums only to face the argument in each separate case (including, potentially, from the taxpayer named in an installment agreement) that the person or persons not party to that suit were solely or principally liable for non-payment of the taxes at issue. The proposed regulations provide, however, that if a taxpayer named in an installment agreement is joined in a proceeding and the IRS obtains a judgment against that person, then collection will continue to occur pursuant to the terms of the installment agreement.

The regulations provide that the statute of limitations for collection under section 6502 is suspended while a proposed installment agreement is pending, for thirty days after rejection or termination of an installment agreement, and during a timely filed appeal of the rejection or termination decision. The running of the collection statute resumes, however, after an installment agreement takes effect. The statute of limitations for collection shall continue to run if an exception under this section applies and levy is not prohibited with respect to the taxpayer.

These regulations apply to installment agreements proposed or entered into on or after the date final regulations are published in the **Federal Register**. However, the rules set forth in these regulations mirror practices the IRS has been following administratively since the enactment of RRA 1998.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has 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 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 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 Requests for a 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) or electronically generated comments that are submitted timely to the IRS. The IRS generally requests any comments on the clarity of the proposed rule and how it may be made easier to understand.

All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Frederick W. Schindler, Office of the Associate Chief Counsel (Procedure & Administration), Collection, Bankruptcy & Summonses Division.

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Sections 301.6331–3 and 301.6331–4 are added to read as follows:

§ 301.6331–3 Restrictions on levy while offers to compromise are pending.

Cross-reference. For provisions relating to the making of levies while an offer to compromise is pending, see § 301.7122–1T.

§ 301.6331–4 Restrictions on levy while installment agreements are pending or in effect.

(a) *Prohibition on levy*—(1) *In general.* No levy may be made to collect a tax liability that is the subject of an installment agreement during the period that a proposed installment agreement is pending with the Internal Revenue Service (IRS), for 30 days immediately following the rejection of a proposed installment agreement, during the period that an installment agreement is in effect, and for 30 days immediately following the termination of an installment agreement. If, within the 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with the IRS Office of Appeals, no levy may be made while the rejection or termination is being considered by Appeals.

(2) *When a proposed installment agreement becomes pending.* A proposed installment agreement becomes pending when it is accepted for processing. The proposed installment agreement remains pending until the IRS accepts the proposal, the IRS notifies the taxpayer that the proposal has been rejected, or the proposal is withdrawn by the taxpayer. If a proposed installment agreement that has been accepted for processing does not contain sufficient information to permit the IRS to evaluate whether the proposal should be accepted, the IRS will request the taxpayer to provide the needed additional information. If the taxpayer does not submit the additional information that the IRS has requested within a reasonable time period after such a request, the IRS may reject the proposed installment agreement.

(3) *Revised proposals of installment agreements submitted following rejection.* If, following the rejection of a proposed installment agreement, the taxpayer makes a good faith revision of the proposal and submits the revision within 30 days of the date of rejection, no levy may be made while the IRS considers the revised proposal of an installment agreement.

(4) *Exceptions.* Paragraph (a)(1) of this section shall not prohibit levy if the taxpayer files a written notice with the IRS that waives the restriction on levy

imposed by this section, the IRS determines that the proposed installment agreement was submitted solely to delay collection, or the IRS determines that collection of the tax to which the installment agreement or proposed installment agreement relates is in jeopardy. This section will not prohibit levy to collect from any person other than the person named on the installment agreement.

(b) *Other actions by the IRS while levy is prohibited*—(1) *In general.* The IRS may take actions other than levy to protect the interests of the Government with regard to the liability named in an installment agreement or proposed installment agreement. Those actions include, for example—

- (i) Crediting an overpayment against the liability pursuant to section 6402;
- (ii) Filing or refiling notices of Federal tax lien; and
- (iii) Taking action to collect from any person who is not named on the installment agreement or proposed installment agreement but who is liable for the tax to which the installment agreement relates.

(2) *Proceedings in court.* The IRS will not begin a proceeding in court for the collection of any liability to which an installment agreement or proposed installment agreement relates against a person named in that installment agreement while levy is prohibited by paragraph (a)(1) of this section. In any refund action, however, the IRS may file a counterclaim or third-party complaint against a person without regard to whether that person is named in an installment agreement or proposed installment agreement. In addition, the IRS may join a person named in an installment agreement in any other proceeding in which liability for the tax that is the subject of the installment agreement may be established or disputed, and may file a claim in any bankruptcy proceeding, insolvency action, or interpleader case commenced by other creditors of the taxpayer. If a person named in an installment agreement is joined in a proceeding and the IRS obtains a judgment against that person, collection will continue to occur pursuant to the terms of the installment agreement.

(c) *Statute of limitations*—(1) *Suspension of the statute of limitations on collection.* The statute of limitations under section 6502 for collection of any liability shall be suspended during the period that a proposed installment agreement is pending with the IRS, for 30 days immediately following the rejection of a proposed installment agreement, and for 30 days immediately following the termination of an

installment agreement. If, within the 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with the IRS Office of Appeals, the statute of limitations for collection shall be suspended while the rejection or termination is being considered by Appeals. The statute of limitations for collection shall continue to run if an exception under paragraph (a)(4) of this section applies and levy is not prohibited with respect to the taxpayer.

(2) *Waivers of the statute of limitations on collection.* The IRS may continue to request, to the extent permissible under section 6502 and § 301.6159-1, that the taxpayer agree to a reasonable extension of the statute of limitations for collection.

(d) *Effective date.* This section is applicable on the date final regulations are published in the **Federal Register**.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

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POSTAL SERVICE

39 CFR Part 111

New Specifications for Automated Flats

AGENCY: Postal Service.

ACTION: Proposed rule.

SUMMARY: The Automated Flat Sorting Machine (AFSM) 100 represents the next step into the automated processing environment envisioned for flats mail. Mailpieces that currently qualify for automation flat rates under FSM 881 standards (*Domestic Mail Manual* C820.2.0) will be eligible for the automation flat rates provided the pieces meet the physical criteria for processing on the AFSM 100 and other preparation requirements.

DATES: Comments must be received on or before May 6, 2002.

ADDRESSES: Mail or deliver written comments to the Manager, Mail Preparation and Standards, Postal Service Headquarters, 1735 N Lynn Street, Room 3025, Arlington VA 22209-6038. Copies of all written comments will be available for inspection and photocopying at Postal Service Headquarters Corporate Library, 475 L'Enfant Plaza, SW, Room 11800, Washington, DC, between 9 a.m. and 4 p.m., Monday through Friday.

FOR FURTHER INFORMATION CONTACT: Karen A. Magazino, (703) 292-3644.

SUPPLEMENTARY INFORMATION: AFSM 100 deployment will be completed in April 2002 with 534 systems installed in field offices. With deployment of the AFSM 100s, the FSM 881s are being phased out. Currently, pieces may qualify for a flats automation rate based on the FSM 881 physical criteria as defined in *Domestic Mail Manual* (DMM) C820. The Postal Service plans to replace the current FSM 881 standards, with new criteria based on the physical mailpiece requirements for the AFSM 100.

Processing mail on the AFSM 100 provides tremendous savings opportunities. One of the Postal Service's objectives is to reduce processing costs by moving flat's processing from the labor-intensive manual/mechanized environment to the more efficient automated mode. The additional machine capacity provided by AFSM 100 deployment enables a reduction in the overall amount of mail processed in manual/mechanized operations.

The processing and technological capabilities of the AFSM 100 machine are vastly superior to those of the FSM 881. The AFSM 100 has three automatic feeders with throughput rates capable of exceeding 17,000 pieces per hour, and 120 individual sort separations. Challenges that arise with high speed feeders compared to manual inductions include singulation (double feeds) and acceleration (jams, stoppages). The AFSM 100 also has Optical Character (OCR) and Barcode (BCR) reader functionality. The reader scans the mailpiece in search of an address block and barcode. If a POSTNET barcode is found, the piece is sorted based on the ZIP Code information. If a POSTNET barcode is not found or cannot be read, the OCR looks for the delivery address and the piece is sorted based on the result returned by the OCR.

If the address is unreadable by the OCR, a video-coding operator must key the image and the pieces then sorted to the correct bin or worked manually. The AFSM 100 does not apply (spray on) a POSTNET barcode.

To determine the range of mailpieces compatible with the AFSM 100, we conducted controlled tests using a variety of physical mailpiece characteristics. Three mail characteristic studies were performed: a preliminary test in Baltimore, Maryland, from February 26, 2001, to March 13, 2001; a test in Denver, Colorado, from July 9, 2001, to August 1, 2001; and a study to determine maximum weight conducted in Palantine, Illinois from February 25, 2002, to March 12, 2002.

The mailing industry assisted the Postal Service and supplied many of the