(G)(3). The final penalty disposition will be in an amount ranging from a minimum of 50 percent of the loss of revenue to a maximum of 100 percent of the loss of revenue.

(e) *Fraudulent Violations.* The final penalty disposition will be determined in the same manner as in the case of fraudulent violations committed by persons who are not participants in the drawback compliance program (see paragraph (F)(2)(c)).

(5) *Final Penalty Disposition When There Has Been A Prior Disclosure.* The final penalty disposition will be determined in the same manner as in the case of persons who are not participants in the drawback compliance program (see paragraph (F)(3)).

(H) Violations by Small Entities

In compliance with the mandate of the Small Business Regulatory Enforcement Fairness Act of 1996, under appropriate circumstances, the issuance of a penalty under section 593A may be waived for businesses qualifying as small business entities. Procedures that were established for small business entities regarding violations of 19 U.S.C. 1592 in Treasury Decision 97–46 published in the **Federal Register** (62 FR 30378) are also applicable for small entities regarding violations of section 593A.

PART 191—DRAWBACK

1. The authority citation for part 191 continues to read in part as follows:

Authority: 5 U.S.C. 301; 19 U.S.C. 66, 1202 (General Note 20, Harmonized Tariff Schedule of the United States), 1313, 1624.

* * * * *

§§ 191.191–191.195 also issued under 19 U.S.C. 1593a.

2. In § 191.194, paragraphs (e) and (f) are revised to read as follows:

§ 191.194 Action on application to participate in compliance program.

* * * * *

(e) *Certification removal*—(1) *Grounds for removal.* The certification for participation in the drawback compliance program by a party may be removed when any of the following conditions are discovered:

(i) The certification privilege was obtained through fraud or mistake of fact;

(ii) The program participant is no longer in compliance with the Customs laws and regulations, including the requirements set forth in § 191.192;

(iii) The program participant repeatedly files false drawback claims or false or misleading documentation or other information relating to such claims; or

(iv) The program participant is convicted of any felony or has committed acts which would constitute a misdemeanor or felony involving theft, smuggling, or any theft-connected crime.

(2) *Removal procedure.* If Customs determines that the certification of a program participant should be removed, the applicable drawback office will serve the program participant with written notice of the removal. Such notice will inform the program participant of the grounds for the removal and will advise the program participant of its right to file an appeal of the removal in accordance with paragraph (f) of this section.

(3) *Effect of removal.* The removal of certification will be effective immediately in cases of willfulness on the part of the program participant or when required by public health, interest, or safety. In all other cases, the removal of certification will be effective when the program participant has received notice under paragraph (e)(2) of this section and either no appeal has been filed within the time limit prescribed in paragraph (f)(2) of this section or all appeal procedures have been concluded by a decision that upholds the removal action. Removal of certification may subject the affected person to penalties.

(f) *Appeal of certification denial or removal*—(1) *Appeal of certification denial.* A party may challenge a denial of an application for certification as a participant in the drawback compliance program by filing a written appeal, within 30 days of issuance of the notice of denial, with the applicable drawback office. A denial of an appeal may itself be appealed to Customs Headquarters, Office of Field Operations, Office of Trade Programs, within 30 days after issuance of the applicable drawback office's appeal decision. Customs Headquarters will review the appeal and will respond with a written decision within 30 days after receipt of the appeal unless circumstances require a delay in issuance of the decision. If the decision cannot be issued within the 30-day period, Customs Headquarters will advise the appellant of the reasons for the delay and of any further actions which will be carried out to complete the appeal review and of the anticipated date for issuance of the appeal decision.

(2) *Appeal of certification removal.* A party who has received a Customs notice of removal of certification for participation in the drawback compliance program may challenge the removal by filing a written appeal, within 30 days after issuance of the notice of removal, with the applicable drawback office. A denial of an appeal may itself be appealed to Customs Headquarters, Office of Field Operations, Office of Trade Programs, within 30 days after issuance of the applicable drawback office's appeal decision. Customs Headquarters will consider the allegations upon which the removal was based and the responses made to those allegations by the appellant and will render a written decision on the appeal within 30 days after receipt of the appeal.

Approved: January 19, 2000.

Raymond W. Kelly,

Commissioner of Customs.

John P. Simpson,

Deputy Assistant Secretary of the Treasury.

[FR Doc. 00–1681 Filed 1–24–00; 8:45 am]

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DEPARTMENT OF TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8866]

RIN 1545–AV48

Equity Options With Flexible Terms; Special Rules and Definitions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance on the application of the rules governing qualified covered calls. The new rules address concerns that were created by the introduction of new financial instruments after the enactment of the qualified covered call rules. The final regulations will provide guidance to taxpayers writing qualified covered calls.

EFFECTIVE DATE: These regulations are effective January 25, 2000.

FOR FURTHER INFORMATION CONTACT: Pamela Lew of the Office of Assistant Chief Counsel (Financial Institutions and Products), (202) 622–3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On June 25, 1998, the IRS published in the **Federal Register** proposed regulations (REG–104641–97, 63 FR 34616) addressing whether strike prices available for equity options with flexible terms affect the definition of a qualified covered call (QCC) under section 1092(c)(4) for equity options with standardized terms. No requests to speak at a public hearing were received, and no public hearing was held.

Two written comments were received. These comments focused on whether equity options with flexible terms should be eligible for QCC treatment. After considering these comments, the IRS and Treasury have decided to address the eligibility of equity options with flexible terms and certain other equity options for QCC treatment in other forthcoming guidance.

One of the comments also suggested a clarifying change to the text of the proposed regulations. After revising the regulation to take into account this comment, the proposed regulations are adopted by this Treasury decision.

Explanation of Provisions

Section 1092(c) defines a straddle as offsetting positions with respect to personal property. Under section 1092(d)(3), stock is personal property if the stock is part of a straddle that involves an option on that stock or substantially identical stock or securities. Under section 1092(c)(4), however, writing a QCC option and owning the optioned stock is not treated as a straddle for purposes of section 1092.

In order to be a QCC, a call option must, among other things, be exchange-traded and not be deep in the money. An option is deep in the money if the strike price of the option is lower than the lowest qualified bench mark for the stock. This bench mark is generally the highest available strike price for an option on the stock that is less than the applicable stock price.

At the time the QCC provisions were enacted, exchange-traded options were available only at standardized maturity dates and strike price intervals. This fixed-interval system was a basic assumption of the Congressional plan for QCCs and, more specifically, was the foundation for the definition of a deep-in-the-money option.

Certain options exchanges have begun to trade equity options with flexible terms. Unlike standardized exchange-traded options, these options could have strike prices at other than fixed intervals. For this reason, there is concern that the strike prices established for equity options with flexible terms could impact the bench-mark system for standardized exchange-traded options.

The proposed regulations provide that strike prices established by equity options with flexible terms are not taken into account in determining whether options that are not equity options with flexible terms are deep in the money. Thus, the existence of strike prices established by equity options with flexible terms does not affect the lowest qualified bench mark, as determined under section 1092(c)(4)(D), for an equity option with standardized terms.

One commentator was concerned that usage of the phrase ''existence of strike prices established by equity options without standardized terms'' might be interpreted as requiring actual trading at a particular strike price. The commentator suggested that the regulation be modified to discuss the availability of a strike price for equity options with flexible terms rather than the existence of a strike price established by equity options with flexible terms. This suggestion has been incorporated into the final regulation.

Special Analyses

It has been determined that this Treasury decision 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 regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking 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 Pamela Lew, Office of Assistant Chief Counsel (Financial Institutions and Products). 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.

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 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *. Section 1.1092(c)–1 also issued under 26 U.S.C. 1092(c)(4)(H). * * *

Par. 2. Section 1.1092(c)–1 is added to read as follows:

§ 1.1092(c)–1 Equity options with flexible terms.

(a) *In general.* Section 1092(c)(4) provides an exception to the general rule that a straddle exists if a taxpayer holds stock and writes a call option on that stock. Under section 1092(c)(4), the ownership of stock and the issuance of a call option meeting certain requirements result in a qualified covered call, which is exempted from the general straddle rules of section 1092. This section addresses the consequences of the availability of equity options with flexible terms under the qualified covered call rules.

(b) *No effect on lowest qualified bench mark for standardized options.* The availability of strike prices for equity options with flexible terms does not affect the determination of the lowest qualified bench mark, as defined in section 1092(c)(4)(D), for an option that is not an equity option with flexible terms.

(c) [Reserved].

(d) *Definitions.* For purposes of this section

(1) *Equity option with flexible terms* means an equity option—

(i) That is described in any of the following Securities

Exchange Act Releases—

(A) Self-Regulatory Organizations; Order Approving Proposed Rule Changes and Notice of Filing and Order Granting Accelerated Approval of Amendments by the Chicago Board Options Exchange, Inc. and the Pacific Stock Exchange, Inc., Relating to the Listing of Flexible Equity Options on Specified Equity Securities, Securities Exchange Act Release No. 34–36841 (Feb. 21, 1996); or

(B) Self-Regulatory Organizations; Order Approving Proposed Rule Changes and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2 and 3 to the Proposed Rule Change by the American Stock Exchange, Inc., Relating to the Listing of Flexible Equity Options on Specified Equity Securities, Securities Exchange Act Release No. 34–37336 (June 27, 1996); or

(C) Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2, 4 and 5 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to the Listing of Flexible Exchange Traded Equity and Index Options, Securities Exchange Act Release No. 34–39549 (Jan. 23, 1998); or

(D) Any changes to the SEC releases described in paragraphs (d)(1)(i)(A) through (C) of this section that are approved by the Securities and Exchange Commission; or

(ii) That is traded on any national securities exchange which is registered with the Securities and Exchange Commission (other than those described in the SEC Releases set forth in paragraph (d)(1)(i) of this section) or other market which the Secretary determines has rules adequate to carry out the purposes of section 1092 and is—

(A) Substantially identical to the equity options described in paragraph (d)(1)(i) of this section; and

(B) Approved by the Securities and Exchange Commission in a Securities Exchange Act Release.

(2) *Securities Exchange Act Release* means a release issued by the Securities and Exchange Commission. To determine identifying information for releases referenced in paragraph (d)(1) of this section, including release titles, identification numbers, and issue dates, contact the Office of the Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549. To obtain a copy of a Securities Exchange Act Release, submit a written request, including the specific release identification number, title, and issue date, to Securities and Exchange Commission, Attention Public Reference, 450 5th Street, NW., Washington, DC 20549.

(e) *Effective date.* These regulations apply to equity options with flexible terms entered into on or after January 25, 2000.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved: January 17, 2000.

Jonathan Talisman,

Acting Assistant Secretary of the Treasury.

[FR Doc. 00–1527 Filed 1–21–00; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8868]

RIN 1545–AV68

Termination of Puerto Rico and Possession Tax Credit; New Lines of Business Prohibited

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and Temporary regulations.

SUMMARY: This document amends the Income Tax Regulations by removing temporary regulations that provide guidance regarding the addition of a substantial new line of business by a possessions corporation that is an existing credit claimant and adding final regulations. These regulations are necessary to implement changes made by the Small Business Job Protection Act of 1996.

DATES: *Effective Date.* These regulations are effective January 25, 2000.

FOR FURTHER INFORMATION CONTACT: Daniel S. Karen, (202) 874–1490, or Jacob Feldman, (202) 622–3830 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 1601(a) of the Small Business Job Protection Act of 1996, Public Law 104–188, 110 Stat. 1755 (1996), amended the Internal Revenue Code by adding section 936(j). Section 936(j) generally repeals the Puerto Rico and possession tax credit for taxable years beginning after December 31, 1995. However, the section provides grandfather rules under which a corporation that is an existing credit claimant would be eligible to claim credits for a transition period. The Puerto Rico and possession tax credit and the Puerto Rico economic activity credit phase out for these existing credit claimants ending with the last taxable year beginning before January 1, 2006.

For taxable years beginning after December 31, 1995 and before January 1, 2006, the Puerto Rico and possession tax credit and the Puerto Rico economic activity credit apply only to a corporation that qualifies as an existing credit claimant (as defined in section 936(j)(9)(A)). The determination of whether a corporation is an existing credit claimant is made separately for each possession. A possessions corporation that adds a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) after October 13, 1995, ceases to be an existing credit claimant as of the beginning of the taxable year during which such new line of business is added. Therefore, a possessions corporation that ceases to be an existing credit claimant either because it has added a substantial new line of business, or because a new line of business becomes substantial, during a taxable year may not claim the Puerto Rico and possession tax credit or the Puerto Rico economic activity credit for that taxable year or any subsequent taxable year.

On August 19, 1998, temporary regulations were published in the **Federal Register** (63 FR 44387). A cross referenced Notice of Proposed Rulemaking was also published in the **Federal Register** (63 FR 44416) on the same date. Three comments were received with respect to the Notice. No hearing was requested and none was held. The temporary regulations are, therefore, adopted as proposed with the following changes, as explained, below.

Explanation of Revisions and Summary of Comments

Minor and conforming changes were made in these final regulations. Several changes were also made in the final regulations with regard to the three comments that were received on the Notice of Proposed Rulemaking.

The first comment received addressed the issue as to whether the leasing of some of the assets of an existing credit claimant would result in a new line of business under section 936(j)(9)(B) with respect to the leasing activity. In response to the comment, the final regulations provide that the leasing out of assets by an existing credit claimant (and the employees necessary to operate the leased assets) will not be treated as a new line of business provided that: (1) The existing credit claimant used the leased assets in an active trade or business for at least five years; (2) the existing credit claimant does not through its own officers or staff of employees perform management or operational functions (but not including operational functions performed through leased employees) with respect to the leased assets; and (3) the existing credit claimant does not perform marketing functions with respect to the leasing of the assets. The income from the leasing of assets will not be income from the active conduct of a trade or business, and therefore, the existing credit claimant may not receive a possession tax credit with respect to such income.

A second comment asked for clarification as to whether a taxpayer seeking to be treated as an existing credit claimant through the acquisition of the assets of an existing credit claimant pursuant to section 936(j)(9)(A)(ii) must acquire all the assets of the acquired corporation even in cases in which the existing credit claimant has more than one trade or business. The final regulations have been clarified to conform to the language of section 936(j)(9)(A)(ii) and provide that an acquiring corporation need only acquire all the assets of a single trade or business to be treated as an existing credit claimant.

The third comment asked for clarification as to when the assets of a trade or business are measured for purposes of satisfying the requirement that all the assets of a trade or business must be acquired from an existing credit claimant in order to satisfy section 936(j)(9)(A)(ii). Specifically, the comment expressed concern that assets