

Treasury Decision 8268, 26, CFR, IRC Sec(s). 42

AGENCY:

Internal Revenue Service, Treasury.

ACTION:

Temporary regulations.

SUMMARY:

This document contains temporary regulations relating to the requirements that must be met for an investment to qualify under section 936(d)(4) as an investment in qualified Caribbean Basin Countries. Subject to such conditions as are prescribed by regulation, funds of possessions corporations that are invested by financial institutions in active business assets or development projects in a qualified Caribbean Basin country are to be treated as used in Puerto Rico for purposes of section 936(d)(2). The regulations prescribe the conditions for such an investment to qualify as for use in Puerto Rico under section 936(d)(4). The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in the Proposed Rules section of this issue of the Federal Register.

EFFECTIVE DATE:

This temporary regulation is to be effective for investments made by a possessions corporation in a financial institution that are used by a financial institution for investments in accordance with a specific authorization granted by the Commissioner of Financial Institutions of Puerto Rico after September 22, 1989.

FOR FURTHER INFORMATION CONTACT:

Christine Halphen (202-377-9493, not a toll-free call) or W. Edward Williams (202-287-4851, not a toll-free call) of the Office of Associate Chief Counsel (International) within the Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC 20224 (Attention: CC:CORP:T:R (INTL-955-86)), (202-287-4851, not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1138. The estimated

average annual burden per respondent/recordkeeper is 30 hours depending on individual circumstances.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending on their particular circumstances.

For further information concerning this collection of information, where to submit comments on this collection of information, the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-reference notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register.

Background

This document contains temporary Income Tax Regulations (26 CFR part 1) under section 936(d)(4) of the Internal Revenue Code of 1986, which section was enacted by section 1231(c) of the Tax Reform Act of 1986 (100 Stat. 2085).

Need for Temporary Regulations

Guidance as to the requirements that must be met for an investment by a possessions corporation to qualify under section 936(d)(4) is needed as soon as possible in order to assist the making of loans under the Caribbean Basin initiative program. Therefore, good cause is found to dispense with the notice and public procedure requirements of 5 U.S.C. 553(b) and the delayed effective date requirement of 5U.S.C.553(d).

Explanation of Provision

Section 1231(c) of the Tax Reform Act of 1986, Public Law 99-514 (Oct. 22, 1986), expands the definition of qualified possessions source investment income ("QPSII") by adding section 936(d)(4) to the Internal Revenue Code, effective for taxable years beginning after December 31, 1986. The purpose of the amendment is primarily to help promote economic development in qualified countries in the Caribbean region by allowing funds of possessions corporations to be invested not only in the U.S. possession where the possessions corporation conducts its business, but also, after 1986, in business and development projects in those Caribbean countries. The provision is essentially targeted to possessions corporations operating in Puerto Rico with the anticipation that it will help make new funds available for qualified Caribbean projects at reasonable rates of interest, reflecting the quasi-tax exemption granted to QPSII (by reason of the U.S. possessions tax credit under section 936 of the Code and substantial tax exemptions in Puerto Rico). The provision originated in the House Ways and Means Committee, and the Committee's Report indicates that the Government of Puerto Rico will make a good faith effort to commit \$100 million annually of new funds for private direct investment in qualified Caribbean countries. Furthermore, the Committee's Report, as well as the Report of the Conference Committee, anticipates that the funds for investment are to be made available, without additional cost to the United States, from a variety of sources including possessions corporations (in exchange for future Puerto Rican tax concessions), Government Development Bank funds, and grants by the Government

of Puerto Rico. See H. Rep. No. 99-426, 99th Cong., 1st Sess. 413, 420 (Dec. 7, 1985); and H. Rep. No. 99-841, Vol. II, 99th Cong., 2d Sess. 631, 632 (Sept. 18, 1986).

Section 936(d) of the Internal Revenue Code defines QPSII generally as gross income that a possessions corporation derives from sources within the U.S. possession in which it conducts an active trade or business and that is attributable to the investment in such possession, for use therein, of the possessions corporation's funds. Thus, the passive investment income of a possessions corporation that conducts an active trade or business in Puerto Rico would qualify as QPSII only if the income is from sources within Puerto Rico and the funds invested by the possessions corporation are for use in Puerto Rico. New section 936(d)(4), enacted by the Tax Reform Act of 1986, expands the definition of QPSII by providing, in substance, that an investment in a financial institution will, subject to such conditions as the Secretary of the Treasury prescribes pursuant to regulations, be treated as used in Puerto Rico to the extent used by such financial institution for investment in accordance with the goals and purposes of the Caribbean Basin Economic Recovery Act (Pub. L. 98-67 (Aug. 5, 1983), 97 Stat. 384, 19 U.S.C. 2701 et seq.), in active business assets or development projects in a qualified Caribbean Basin country. Regulations will be issued under section 936(d)(2) regarding the applicable rules for determining the source of income from investments made by a possessions corporation. It is anticipated that such regulations will reflect the previously stated position that income from section 936 funds made available for a qualified CBI investment through loans from a possessions corporation to a Puerto Rican financial institution which would then loan the funds on substantially identical terms to certain CBI obligors will be treated as Puerto Rican source income for purposes of determining whether such income qualifies as QPSII. See letter from the Assistant Secretary for Tax Policy of the Treasury Department to Congressma n Charles Rangel, dated August 24, 1988.

Section 1.936-10T(c) of the temporary regulation provides guidance with respect to section 936(d)(4), principally in terms of the requirements for investments to qualify under section 936(d)(4) and certain certification and due diligence requirements.

Paragraph (c)(1) outlines the general requirements for an investment to be a qualified investment for purposes of section 936(d)(4): (1) The investment is a loan made out of the possessions corporation's qualified funds; (2) the loan is made by a qualified financial institution; (3) the loan is made to a qualified recipient for investment in active business assets or a development project in a qualified Caribbean Basin country; (4) the investment is authorized by the Commissioner of Financial Institutions of Puerto Rico under regulations issued by such Commissioner; and (5) the qualified recipient and the qualified financial institution comply with certain certification, agreement, and due diligence requirements.

Paragraph (c)(2) makes clear that an investment that qualifies for purposes of section 936(d)(4) when made must continue to meet the qualification requirements in order to retain its qualified status. However, substantial compliance rules are provided that allow correction of a failure to comply within a reasonable period of time after such failure is, or should have been, discovered. Also, failure to comply with due diligence requirements does not automatically disqualify an investment if the failure is due to reasonable cause and the financial institution or the qualified recipient can establish that the funds were properly invested.

Paragraph (c)(3) defines "qualified financial institution" as any entity that both qualifies as a banking, financing or similar business under §1.864-4(c)(5)(i) of the Treasury Regulations and is an "eligible institution", as defined in section 4.2.13 of Regulation No. 3582 promulgated by the Office of the Commissioner of Financial Institutions in Puerto Rico to regulate those institutions that are eligible to pay tax-exempt interest under the Puerto Rico Industrial and Tax Incentive Acts. Generally, an eligible institution is a depository institution that is regulated by the Office of the Commissioner of Financial Institutions and other banking authorities in Puerto Rico and is authorized by the Commissioner of Financial Institutions to receive certain funds from exempted businesses (including from possessions corporations) pursuant to regulation No. 3582. The term "qualified financial institution" also includes the Government Development Bank for Puerto Rico, the Puerto Rico Economic Development Bank, as well as any other entity which the Internal Revenue Service may determine to be a qualified financial institution. A qualified financial institution does not include a branch that a Puerto Rican bank or other financial institution may maintain outside of Puerto Rico.

Paragraph (c)(4) defines an investment in active business assets generally as a loan to a qualified recipient for the acquisition, construction, rehabilitation, improvement, upgrading or expansion by the qualified recipient of qualified assets for use by the recipient in a qualified business activity and for the financing of expenditures incidental to such acquisition. The qualified recipient must own the qualified assets rather than lease or license them. Qualified assets are: (1) Newly constructed or improved real property; (2) tangible personal property (including capital expenditures for the reconditioning, upgrading, transformation or improvement of any tangible personal property), provided such tangible personal property is either new property or used property that at no time during the preceding 5-year period was used in a business activity in the qualified Caribbean Basin country in which the property is to be used; (3) intangible property rights (not including U.S. rights or rights acquired from a related person), provided the rights were at no time during the preceding 5-year period used in a business activity in the qualified Caribbean Basin country in which the property is to be used; and (4) exploration and development expenditures relating to oil, gas or mineral deposits. The regulations leave open the possibility for the Service to qualify other assets either by way of published rulings or private letter rulings. Paragraph (c)(4)(iii) defines incidental expenditures as expenditures associated with placing qualified assets in service, including reasonable costs associated with arranging the financing of the investment and de minimis amounts for working capital requirements and the refinancing of existing debt. Paragraph (c)(4)(iv) defines a qualified business activity as a lawful industrial or commercial activity that is conducted as an active trade or business (using standards similar to those described in §1.367-2T(b) (2) and (3)) in a qualified Caribbean Basin country. A trade or business is generally defined in reference to various business classifications used in the 1987 Standard Industrial Classification Manual.

Paragraph (c)(5) defines an investment in a development project generally as an investment in qualified assets for use in either a facility in a qualified Caribbean Basin country that either supports local economic development and satisfies a public use requirement or supports the performance in a qualified Caribbean Basin country of a non-commercial governmental function (other than military activities).

Paragraph (c)(6) contains temporary period rules that specify the time limits within which loan or bond proceeds disbursed to a qualified recipient must be used to pay for the costs of the investment in qualified business assets or the development project. Generally, loan or bond proceeds must be invested within six months of disbursement or date of issue. A longer temporary period is allowed under paragraph (c)(6)(ii) in the case of a construction project or a long-term contract that is financed out of bond proceeds. In that case, the temporary period is as long as is reasonably required to complete the project or contract, based upon a plan filed with, and approved by, the Commissioner of Financial Institutions of Puerto Rico prior to the date of issue.

Rules are also provided in paragraph (c)(6)(iv) concerning the investment of loan or bond proceeds during a temporary period. Generally, the loan or bond proceeds may be held in unrestricted yield investments during the six-month period beginning with the date of disbursement of loan proceeds to the borrower or the date of issue, but the investments must give rise to income sourced in Puerto Rico or in the Caribbean Basin country in which the investment is made. Any bond proceeds allowed to be held beyond the six-month period must be invested in eligible activities in Puerto Rico, as defined under Puerto Rican Regulation No. 3582.

Paragraph (c)(7) contains rules regarding the replacement of temporary financing with permanent financing that qualifies for QPSII treatment and the refunding of existing QPSII-qualified bond issues or loan arrangements.

Paragraph (c)(8) contains miscellaneous operating rules, including rules concerning the use of a financial intermediary other than a qualified financial institution to loan funds to a qualified recipient for an investment in active business assets or in a development project.

Paragraph (c)(9) defines a qualified recipient as a person described in section 7701(a)(1) of the Code that is engaged in a qualified business activity or a government of a qualified Caribbean Basin country, provided such person or government complies with the agreement and representation requirements of paragraph (c)(11).

Paragraph (c)(10) defines an investment in a qualified Caribbean Basin country generally as an investment in an active business asset or a development project located or used in the qualified Caribbean Basin country. A qualified Caribbean Basin country is defined as the U.S. Virgin Islands and any beneficiary country that meets the requirements of section 274(h)(6)(A) (i) and (ii), and includes the territorial waters and continental shelf thereof.

The balance of the temporary regulation deals with the agreements and representations required of qualified recipients and qualified financial institutions, including the certification requirement in section 936(d)(4)(C)(i) and the due diligence requirements imposed upon qualified financial institutions. The due diligence requirements in the temporary regulation are based on requirements in regulations promulgated by the Puerto Rican government.

The temporary regulations contain no special provisions regarding the funding of privatization transactions. Comments are solicited as to the circumstances in which

funding of a privatization should qualify as an investment in active business assets as opposed to a mere refinancing of existing investments.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also 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 regulations, and, therefore, a final Regulatory Flexibility Analysis is not required.

Drafting Information

The principal authors of these regulations are Christine Halphen and W. Edward Williams of the Office of the Associate Chief Counsel (International) within the Office of Chief Counsel, Internal Revenue Service. Other personnel from offices of the Internal Revenue Service and the Treasury Department participated in developing these regulations.

List of Subjects in 26 CFR 1.861-1 Through 1.997-1

Income taxes, Corporate deductions, Aliens, Exports, DISC, Foreign investment in U.S., Foreign tax credit, FSC, Sources of income, U.S. investments abroad.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

Income Tax Regulations

PART 1-[AMENDED]

Paragraph 1. The authority for part 1 continues to read in part:

Authority:

26 U.S.C. 7805.

Par. 2. New §§1.936-8T and 1.936-9T are added and reserved immediately following §1.936-7 to read as follows. New §1.936-10T is added immediately following those sections to read as set forth below.

§1.936-8T. Qualified possession source investment income (Temporary regulations). [Reserved]

§1.936-9T. Source of qualified possession source investment income (Temporary regulations). [Reserved]

§1.936-10T. Qualified investments (Temporary regulations).

(a) In general. [Reserved]

(b) Qualified investments in Puerto Rico. [Reserved]

(c) Qualified investment in certain Caribbean Basin countries-(1) General rule. An investment of qualified funds described in §1.936-10T shall be treated as a qualified investment of funds for use in Puerto Rico if the funds are used for a qualified investment in a qualified Caribbean Basin country. A qualified investment in a qualified Caribbean Basin country is a loan of qualified funds by a qualified financial institution (described in paragraph (c)(3) of this section) to a qualified recipient (described in paragraph (c)(9) of this section) for investment in active business assets (as defined in paragraph (c)(4) of this section) in a qualified Caribbean Basin country (described in paragraph (c)(10)(ii) of this section) or for investment in development projects (as defined in paragraph (c)(5) of this section) in a qualified Caribbean Basin country, provided-

(i) The investment is authorized, prior to disbursement of the funds, by the Commissioner of Financial Institutions of Puerto Rico pursuant to regulations issued by such Commissioner; and

(ii) The agreement, representation, certification, and due diligence requirements under paragraphs (c)(11), (c)(12), and (c)(13) of this section are complied with.

(2) Termination of qualification-(i) In general. An investment that, at any time after having met the requirements for a qualified investment in a qualified Caribbean Basin country under the terms of this paragraph (c), fails to meet any of the conditions enumerated in this paragraph (c) shall no longer be considered a qualified investment in a qualified Caribbean Basin country from the time of such failure, unless the investment satisfies the requirements for substantial compliance described in paragraph (c)(2)(ii) of this section. Such a failure includes, but is not limited to, the occurrence of any of the following events:

(A) Active business assets ceasing to qualify as such;

(B) Proceeds from the investment being diverted for the financing of assets, projects, or operations that are not active business assets or development projects or are not the assets or the project of the qualified recipient;

(C) The qualified recipient's qualified business activity ceasing to qualify as such; or

(D) The qualified Caribbean Basin country ceasing to be a country described in paragraph (c)(10)(ii) of this section.

(ii) Substantial compliance-(A) In general. Substantial compliance with the requirements of this paragraph (c) shall be satisfied if the event or events that cause disqualification of the investment are corrected within a reasonable period of time.

For purposes of this section, a reasonable period of time shall not exceed 60 days after such event or events come to the attention of the qualified recipient or the qualified financial institution or should have come to their attention by the exercise of reasonable diligence.

(B) Due diligence requirements. Substantial compliance with the due diligence requirements of paragraphs (c)(11), (c)(12), and (13) of this section shall be satisfied if the failure to comply is due to reasonable cause and, upon request of the Commissioner of Financial Institutions of Puerto Rico or of the Assistant Commissioner (International) (or his authorized representative), the qualified financial institution, the financial intermediary, or the qualified recipient establishes to the satisfaction of the Commissioner of Financial Institutions of Puerto Rico or of the Assistant Commissioner (International) (or his authorized representative) that it has exercised due diligence in ensuring that the funds were properly disbursed to a qualified recipient and applied by or on behalf of such qualified recipient to uses that qualify the investment as an investment in qualified business assets or a development project under the provisions of this paragraph (c).

(iii) Assumption. An investment shall not cease to qualify merely because the qualified recipient's obligation to the qualified financial institution (or to a financial intermediary, if any) is assumed by another person provided such other person assumes the qualified recipient's agreement and representation requirements under paragraph (c)(11)(i) of this section and is either-

(A) A qualified recipient on the date of assumption, in which case such person shall be treated for purposes of this section as the original qualified recipient and shall be subject to all the requirements of this section for continued qualification of the loan as a qualified investment in a qualified Caribbean Basin country; or

(B) An international organization, the principal purpose of which is to foster economic development in developing countries and which is described in section 1 of the International Organizations Immunities Act (22 U.S.C. 288), if the assumption of the obligation is pursuant to a bona fide guarantee agreement.

(3) Qualified financial institution-(i) General rule. For purposes of section 936(d)(4)(A) and this section, a qualified financial institution includes only-

(A) A banking, financing, or similar business defined in §1.864-4(c)(5)(i) that is an eligible institution described in subdivision (ii) of this paragraph (c)(3), but not including branches of such institution outside of Puerto Rico;

(B) The Government Development Bank for Puerto Rico;

(C) The Puerto Rico Economic Development Bank; and

(D) Such other entity as may be determined by the Commissioner by notice or other guidance published in the Internal Revenue Bulletin or by ruling issued to an entity which establishes its eligibility.

A ruling request from an entity pursuant to this paragraph (c)(3) must set forth sufficient information to establish that the entity is in substance,

purpose, and operation a financial institution of the type referred to in paragraph (c)(3)(i) (A), (B), or (C) of this section.

(ii) Eligible institution. An eligible institution means an institution-

(A) That is organized under the laws of the Commonwealth of Puerto Rico or is the Puerto Rican branch of an institution organized under the laws of another jurisdiction if such branch is engaged in a banking, financing, or similar business defined in §1.864-4(c)(5)(i), and

(B) That qualifies as an eligible institution under section 4.2.13 of Regulation No. 3582 issued by the Commissioner of Financial Institutions of Puerto Rico (hereinafter "Puerto Rican Regulation No. 3582") or any successor thereof.

(4) Investments in active business assets-(i) In general. For purposes of section 936(d)(4)(A)(i)(I) and this section and subject to the provisions of paragraph (c)(8) of this section, a loan qualifies as an investment in active business assets if-

(A) The amounts disbursed under the loan to a qualified recipient are promptly applied by (or on behalf of) the qualified recipient solely for capital expenditures for the construction, rehabilitation, improvement, upgrading or expansion of qualified assets described in paragraph (c)(4)(ii) (A), (B) and (E) of this section, for the acquisition of qualified assets described in paragraph (c)(4)(ii) (B), (C) and (E) of this section, for the expenditures described in paragraph (c)(4)(ii)(D) of this section, and, if applicable, for the financing of expenditures incidental to an investment described in paragraph (c)(4)(iii)(A) of this section;

(B) The qualified recipient owns the assets for United States income tax purposes and uses them in a qualified business activity; and

(C) The requirements of paragraph (c)(6) and (c)(7) of this section (regarding temporary periods, financing of previous incurred costs, and the timing of disbursement of the loan or the issuance of obligations to finance an investment) are satisfied.

(ii) Definition of qualified assets. For purposes of this section, qualified assets mean-

(A) Real property;

(B) Tangible personal property (such as raw materials, furniture, machinery, or equipment) that is not property described in section 1221(1) and that is either new property or property which at no time during the five-year period preceding the date of acquisition with the loan proceeds was used in a business activity in the qualified Caribbean Basin country in which the property is to be used;

(C) Rights to intangible property that is a patent, invention, formula, process, design, pattern, know-how, or similar item, or rights under a franchise agreement, provided that such rights

(1) Were not at any time during the five-year period preceding the date of acquisition with the loan proceeds used in a business activity in the qualified Caribbean Basin country in which the rights are to be used,

(2) Do not include United States rights, and

(3) The qualified recipient acquiring the rights and the person from whom acquired are not related (within the meaning of section 267(b), using "10 percent" instead of "50 percent" in the places where it appears).

(D) Exploration and development expenditures incurred by a qualified recipient for the purpose of ascertaining the existence, location, extent or quality of any deposit of ore, oil, gas, or other mineral in a qualified Caribbean Basin country, as well as for purposes of developing such deposit (within the meaning of section 616 of the Code and the regulations thereunder); and

(E) Other assets that are not described in paragraph (c)(4)(ii) (A) through (D) of this section and that the Commissioner may, by notice or other guidance published in the Internal Revenue Bulletin or by ruling issued to a qualified financial institution or qualified recipient upon its request, determine to be qualified assets.

(iii) Incidental expenditures. An amount in addition to the loan proceeds borrowed to make an investment in active business assets shall be considered an investment in active business assets if such amount is applied to finance expenditures that are incidental to making the investment in active business assets, provided such amount is disbursed at or about the same time the proceeds for making the investment in active business assets are disbursed. For purposes of this section, expenditures that are incidental to an investment in active business assets mean-

(A) A reasonable amount of costs associated with arranging the financing of an investment in active business assets, not to exceed an amount described in section 147(g)(1);

(B) A reasonable amount of installation costs and other reasonable costs associated with placing an active business asset in service in the qualified business activity;

(C) An amount not in excess of 10 percent of the sum of the investment in active business assets and the costs described in paragraph (c)(4)(iii) (A) and (B) of this section to finance reasonable working capital requirements of the recipient's qualified business activity; and

(D) An amount not in excess of 5 percent of the sum of the investment in active business assets and the costs described in paragraph (c)(4)(iii) (A) and (B) of this section for the refinancing of an existing debt of the qualified recipient if such refinancing is incidental to an investment in active business assets.

(iv) Qualified business activity. A qualified business activity is a lawful industrial or commercial activity that is conducted as an active trade or business (under principles similar to those described in §1.367(a)-2T(b) (2) and (3)) in a qualified Caribbean Basin country. A trade or business for purposes of this paragraph (c)(4)(iv) is any business activity meeting the principles of section 367 of the Code and described in

Divisions A through I (excluding group 43 in Division E (relating to the United States Postal Service) and groups 84 (relating to museums, art galleries, and botanical and zoological gardens), 86 (relating to membership organizations), and 88 (relating to private households) in Division I) of the 1987 Standard Industrial Classification Manual issued by the Executive Office of the President, Office of Management and Budget, or in the comparable provisions of any successor Standard Industrial Classification Manual that is adopted by the Commissioner of Internal Revenue in a notice, regulation, or other document published in the Internal Revenue Cumulative Bulletin.

(5) Investments in development projects-(i) In general. For purposes of section 936(d)(4)(A)(i)(II) and this section, and subject to the provisions of paragraph (c)(8) of this section, a loan by a qualified financial institution qualifies as an investment in a development project if-

(A) The amounts disbursed under the loan are promptly applied by (or on behalf of) the qualified recipient solely for investment in qualified assets described in paragraph (c)(4)(i)(A) and in any land, buildings, or other property functionally related and subordinate to a facility described in paragraph (c)(5)(ii) of this section, determined under principles similar to those described in §1.103-8(a)(3), for use (under principles similar to those described in §1.367(a)-2T(b)(5)) in either-

(1) A development project described in subdivision (ii) of this paragraph (c)(5) in a qualified Caribbean Basin country; or

(2) The performance in a qualified Caribbean Basin country of a non-commercial governmental function described in paragraph (c)(5)(iv) of this section; and

(B) The requirements of paragraph (c)(6) and (c)(7) of this section (regarding temporary periods, financing of previous incurred costs, and the timing of disbursement of the loan or issuance of obligations to finance a development project) are satisfied.

(ii) Development project. For purposes of this paragraph (c), a development project is one or more facilities in a qualified Caribbean Basin country that support economic development in that country and that satisfy the public use requirement of paragraph (c)(5)(iii) of this section. Examples of facilities that may meet the public use requirement include but are not limited to-

(A) Transportation systems and equipment, including sea, surface, and air, such as roads, railways, air terminals, runways, harbor facilities, and ships and aircraft;

(B) Communications facilities;

(C) Training and education facilities related to qualified business activities;

(D) Industrial parks, including necessary support facilities such as roads; transmission lines for water, gas, electricity, and sewage; docks; plant sites preparations; power generation; sewage disposal; and water treatment;

(E) Sports facilities;

(F) Convention or trade show facilities;

(G) Sewage, solid waste, water, and electric facilities;

(H) Low-income housing projects intended for occupancy by families and individuals of low or moderate income; and

(I) Hydroelectric generating facilities.

(iii) Public use requirement. To satisfy the public use requirement in paragraph (c)(5)(ii) of this section, a facility must serve or be available on a regular basis for general public use, as contrasted with similar types of facilities which are constructed for the exclusive use of a limited number of persons as determined under principles similar to those described in §1.103-8(a)(2).

(iv) Non-commercial governmental functions. For purposes of paragraph (c)(5)(i)(B) of this section, the term "non-commercial governmental functions" refers to activities that, under U.S. standards, are not customarily attributable to or carried on by private enterprises for profit and are performed for the general public with respect to the common welfare or which relate to the administration of some phase of government. For example, the operation of libraries, toll bridges, or local transportation services, and activities substantially equivalent to those carried out by the Federal Aviation Authority, Interstate Commerce Commission, or United States Postal Service, are considered non-commercial governmental functions. For purposes of this section, non-commercial government functions shall not include military activities.

(6) Rules regarding temporary period. This paragraph (c)(6) provides rules for determining whether amounts disbursed to a qualified recipient by a qualified financial institution shall be considered to have been promptly applied for the purpose of paragraphs (c)(4)(i)(A) and (c)(5)(i)(A) of this section.

(i) Prompt application of borrowed proceeds. Except as otherwise provided in paragraphs (c)(6)(ii) and (c)(7)(iii) of this section, amounts disbursed to a qualified recipient by a financial institution shall be considered to have been promptly applied for the purpose of paragraphs (c)(4)(i)(A) and (c)(5)(i)(A) of this section if the requirements of this paragraph (c)(6)(i) are satisfied.

(A) The amounts are fully expended by, or on behalf of, the qualified recipient for any of the purposes described in paragraph (c)(4)(i)(A) or (c)(5)(i)(A) of this section no later than 6 months from the date of such disbursement. Where the amounts disbursed to the qualified recipient are bond proceeds, the six-month period shall begin on the date of issuance of the bonds.

(B) In the event the qualified financial institution invests any part of the bond proceeds during the temporary period, any proceeds from any such investment shall be paid to the qualified recipient or applied for its benefit.

(ii) Special rules for construction projects or long-term contracts financed out of bond proceeds. In the case of a construction project or a long-term contract described in §1.451-3(b) (1) and (2) that is financed out of bond proceeds, the six-

month period described in paragraph (c)(6)(i) of this section shall be extended with respect to the portion of such bond proceeds used to fund the construction project or the long-term contract for such reasonable period of time as shall be necessary for completion. For purposes of this paragraph (c)(6)(ii), the period of time shall be considered reasonable only if-

(A) The period does not exceed three years from the date of issuance of the bonds;

(B) The construction project or the long-term contract that is financed out of bond proceeds was identified as of the date of issue;

(C) A construction and expenditure plan certified by an independent engineer or architect is filed with, and approved by, the Commissioner of Financial Institutions of Puerto Rico prior to the date of issue, which makes a reasonable estimate, as of the date of filing of the plan, of the amounts and uses of the bond proceeds and the time of completion, and includes a schedule of progress payments until completion; and

(D) The terms of the construction and expenditure plan are disclosed in the public offering memorandum, private placement memorandum, or similar document prepared for information or disclosure purposes in relation to the issuance of bonds.

(iii) Bond proceeds. For purposes of this paragraph (c), bond proceeds shall mean the proceeds from the issuance of obligations by a qualified financial institution by way of a public offering or a private placement, all or part of which are to be made available directly by the qualified financial institution to the qualified recipient for the financing of an investment in active business assets or a development project that has been identified at the time of issue and is described in a public offering memorandum, private placement memorandum, or similar document prepared for information or disclosure purposes in relation to the issuance of bonds.

(iv) Temporary investments-(A) During six-month temporary period. During the six-month temporary period described in paragraph (c)(6)(i) of this section, and during the 30-day temporary period described in paragraph (c)(7)(iii)(A) of this section, loan proceeds disbursed to a qualified recipient, bond proceeds, and proceeds from the investment thereof, may be held in unrestricted yield investments provided that the income from such investments, if any, is or would be sourced either in Puerto Rico or in a country in which the investment in active business assets or development project is to be made.

(B) During other temporary periods. After the expiration of the six-month or 30-day temporary period described in paragraph (c)(6)(iv)(A) of this section, any investment of bond proceeds or investment proceeds within the remainder of the period described in paragraph (c)(6)(ii) or (c)(7)(iii)(B) of this section shall be limited to investments in eligible activities. For purposes of this paragraph (c)(6)(iv)(B), the term "eligible activities" shall mean those investments described in section 6.2.4 of Puerto Rican Regulation No. 3582, as in effect on September 22, 1989.

(7) Financing of previously incurred costs. This paragraph (c)(7) provides rules for determining whether loan proceeds which are disbursed after a qualified recipient has paid or incurred part or all of the costs of acquiring active business assets or

investing in a development project shall be considered to have been applied for such purposes.

(i) Replacement of temporary non-qualified financing. This paragraph (c)(7)(i) prescribes the maximum time limits within which temporary nonqualified financing must be replaced.

(A) In the case of the acquisition of an asset or a facility, the loan proceeds must be disbursed, or the obligations must be issued, no later than six months after the date on which the qualified recipient takes possession of the asset or the facility or, if earlier, places the asset or the facility in service.

(B) In the case of a construction project or a long-term contract, the loan proceeds must be disbursed, or the obligations must be issued, no later than three years after the date on which the first payment is made toward the financeable costs of the construction project or the long-term contract, provided the authorization described in paragraph (c)(1)(i) of this section is issued by the Commissioner of Financial Institutions of Puerto Rico prior to the time of such first payment. The amount of the authorized loan or bond issue may not exceed the sum of-

(1) The costs described in paragraph (c)(4)(i)(A) in the case of an investment in active business assets, or the costs described in paragraph (c)(5)(i) of this section in the case of a development project, and

(2) The portion of unpaid interest accrued on prior temporary non-qualified financing through the date the qualified loan proceeds are disbursed or the qualified obligations are issued that would be required to be capitalized under U.S. tax rules.

(ii) Refunding of qualified financing. A loan or bond issue used to finance a qualified investment in active business assets or in a development project described in paragraph (c)(1) of this section may be refinanced with a qualified new loan or bond issue to the extent of the remaining principal balance on such existing qualified financing, increased by the amount of unpaid interest accrued through the date the new loan proceeds are disbursed or the new obligations are issued that would be required to be capitalized under U.S. tax rules.

(iii) Temporary periods-(A) In general. In the case of a loan or bond issue described in paragraph (c)(7) (i) or (ii) of this section, the temporary period described in paragraph (c)(6)(i)(A) of this section shall apply but shall be limited to 30 days from the date of disbursement of loan proceeds to the qualified recipient or from the date of issue in the case of a bond issue.

(B) Special rules for construction projects or long-term contracts financed out of bond proceeds. In the case of a construction project or a long-term contract financed out of bond proceeds, the 30-day period described in paragraph (c)(7)(iii)(A) of this section shall be extended with respect to the portion of such bond proceeds used for the permanent financing of the construction project or the long-term contract for such reasonable period of time as shall be necessary for completion. For purposes of this paragraph (c)(7)(iii)(B), the period of time shall be considered reasonable only if-

- (1) The period does not exceed three years from the date of issuance of the bonds;
- (2) A construction and expenditure plan certified by an independent engineer or architect is filed with, and approved by, the Commissioner of Financial Institutions of Puerto Rico prior to the date of issue, which makes a reasonable estimate, as of the date of issue, of the amounts and uses of the bond proceeds and the time of completion, and includes a schedule of progress payments until completion; and
- (3) The terms of the construction and expenditure plan are disclosed in the public offering memorandum, private placement memorandum, or similar document prepared for information or disclosure purposes in relation to the bond issue.
- (8) Miscellaneous operating rules-
- (i) Sale and leaseback. An asset that is acquired and leased back to the person from whom acquired does not constitute an investment in an active business asset.
 - (ii) Use of asset in qualified business activity. For purposes of paragraph (c)(4)(i)(B), an asset shall be considered used or for use in a qualified business activity if it is used or for use in such activity under principles similar to those described in §1.367(a)-2T(b)(5), or a successor provision.
 - (iii) Definition of capital expenditures. For purposes of this paragraph (c), capital expenditures mean those expenditures described in section 263(a) of the Code (without regard to paragraphs (A) through (G) of section 263(a)(1)).
 - (iv) Loans through certain financial intermediaries. A loan by a qualified financial institution shall not be disqualified as an investment in active business assets or in a development project merely because the proceeds are first lent to a financial intermediary (as defined in paragraph (c)(8)(iv)(H) of this section) which, in turn, on-lends the proceeds directly to a qualified recipient, provided the requirements of this paragraph (c)(8)(iv) are satisfied. Similarly, a loan by a qualified financial institution shall not be disqualified as an investment in active business assets or in a development project merely because the loan transaction is processed by the central bank of issue of the country into which the loan is made pursuant to, and solely for purposes of complying with, the exchange control laws or regulations of such country.
 - (A) The loan to the qualified recipient satisfies the requirements of paragraph (c)(4)(i) of this section in the case of an investment in active business assets, or of paragraph (c)(5)(i) of this section in the case of an investment in a development project.
 - (B) The qualified recipient and the active business assets or development project in which the proceeds are to be invested have been identified prior to disbursement of any part of the proceeds by the qualified financial institution to the financial intermediary.
 - (C) The effective interest rate charged by the qualified financial institution to the financial intermediary does not exceed the average interest rate paid by the qualified financial institution with respect to its eligible funds, increased by such number of basis points as is required to provide reasonable compensation to the qualified

financial institution for services performed and risks assumed with respect to the loan to the financial intermediary that are not ordinarily required to be performed or assumed with respect to a deposit, loan, repurchase agreement or other transfer of eligible funds with another qualified financial institution. The average interest rate shall be the average rate, determined on a daily basis, paid by the qualified financial institution on its eligible funds over the most recent quarter preceding the date on which the rate on the loan to the financial intermediary is committed.

(D) The effective interest rate charged by the financial intermediary to the qualified recipient does not exceed the effective interest rate charged to the financial intermediary by the qualified financial institution, increased by such number of basis points as is required to provide reasonable compensation to the financial intermediary as determined by the Commissioner of Financial Institutions of Puerto Rico.

(E) The financial intermediary borrows from the qualified financial institution under substantially the same terms as it lends to the qualified recipient. In particular, both loans must have disbursement terms, repayment schedules and maturity dates for interest and principal amounts such that the financial intermediary does not retain for more than 48 hours any of the funds disbursed by the qualified financial institution nor any of the funds paid by the qualified recipient in repayment of principal or interest on the loan.

(F) The financial institution and the financial intermediary agree to comply with the due diligence requirements described in paragraphs (c)(11), (c)(12), and (c)(13) of this section;

(G) The time periods and temporary investments rules in paragraphs (c) (6) and (7) of this section are complied with; and

(H) For purposes of this paragraph (c), the financial intermediary is an active trade or business which a person maintains in a qualified Caribbean Basin country and which consists of a banking, financing or similar business as defined in §1.864-4(c)(5)(i) (other than a central bank of issue) or is a public international organization, the principal purpose of which is to foster economic development in the Caribbean Basin beneficiary countries described in section 212(a)(1)(A) of the Caribbean Basin Economic Recovery Act, Public Law 98-67 (Aug. 5, 1983), 97 Stat. 384, 19 U.S.C. 2702(a)(1)(A) .

For purposes of paragraph (c)(8)(iv) (C) and (D) of this section, the determination of whether compensation is reasonable shall be made in relation to normal commercial practices for comparable transactions carrying a similar degree of commercial, currency and political risk. Reasonable credit enhancement fees and other reasonable fees and amounts charged to the financial intermediary or the qualified recipient with respect to the loan transaction in addition to interest shall be added to the interest cost in determining the effective interest rate.

(v) Privatization. [Reserved]

(9) Qualified recipient. For purposes of this section, a qualified recipient is any person described in subdivision (i) or (ii) of this paragraph (c)(9). The term "person"

means a person described in section 7701(a)(1) or a government (within the meaning of §1.892-2T(a)(1)) of a qualified Caribbean Basin country.

(i) In the case of an investment described in paragraph (c)(4) of this section (relating to investments in active business assets), a qualified recipient is a person that carries on a qualified business activity in a qualified Caribbean Basin country, and complies with the agreement and representation requirements described in paragraph (c)(11)(i) of this section at all times during the period in which the investment remains outstanding.

(ii) In the case of an investment described in paragraph (c)(5) of this section (relating to investments in development projects), a qualified recipient is the borrower (including a person empowered by the borrower to authorize expenditures for the investment in the development project) that has authority to comply with the agreement and representation requirements described in paragraph (c)(11)(i) of this section at all times during the period in which the investment remains outstanding.

(10) Investments in a qualified Caribbean Basin country-(i) Rules for determining the place of an investment. The rules of this paragraph (c)(10)(i) shall apply to determine the extent to which an investment in an active business asset or a development project will be considered made in a qualified Caribbean Basin country.

(A) An investment in real property is considered made in the qualified Caribbean Basin country in which the real property is located.

(B) Except as otherwise provided in this paragraph (c)(10)(i)(B), an investment in tangible personal property is considered made in a qualified Caribbean Basin country so long as the tangible personal property is predominantly used in that country. Whether property is used predominantly in a qualified Caribbean Basin country shall be determined under principles similar to those described in §1.48-1 (g)(1), (g)(2)(ii), (g)(2)(iv), (g)(2)(vi), (g)(2)(viii), and (g)(2)(x) (relating to investment tax credits for property used outside the United States) as in effect on December 31, 1986. A vessel, container, or aircraft shall be considered for use predominantly in a qualified Caribbean Basin country in any year if it is used for transport to and from such country with some degree of frequency during that year and at least 50 percent of the income from the use of such vessel, container or aircraft for that year is sourced in such country under principles similar to those described in section 863(c) (1) and (2) (relating to source rules for certain transportation income). Cables and pipelines which are permanently installed as part of a communication or transportation system between a qualified Caribbean Basin country and another country or among several countries which include a qualified Caribbean Basin country shall be considered used in a qualified Caribbean Basin country to the extent of 50 percent of the portion of the facility that directly links the qualified country to another country or to a hub, unless it is established by notice or other guidance published in the Internal Revenue Bulletin or by ruling issued to a qualified institution or qualified recipient upon request that it is appropriate to attribute a greater portion of the cost of the facility to the qualified Caribbean Basin country.

(C) An investment in rights to intangible property is considered made in a qualified Caribbean Basin country to the extent such rights are used in that country. Where rights to intangible property are used shall be determined under principles similar to those described in §1.954-2T(b)(3)(vii) or a successor provision.

(ii) Qualified Caribbean Basin country. For purposes of this section, the term "qualified Caribbean Basin country" means any beneficiary country (within the meaning of section 212(a)(1)(A) of the Caribbean Basin Economic Recovery Act, Public Law 98-67 (Aug. 5, 1983), 97 Stat. 384, 19 U.S.C. 2702(a)(1)(A)), which meets the requirements of subdivisions (i) and (ii) of section 274(h)(6)(A) and the U.S. Virgin Islands, and includes the territorial waters and continental shelf thereof.

(11) Agreements and representations by qualified recipients and financial intermediaries- (i) In general. In order for an investment to be considered a qualified investment under section 936(d)(4) and paragraph (c)(1) of this section, a qualified recipient must certify to the qualified financial institution (or to the financial intermediary, if the loan is made through a financial intermediary) on the date of closing of the loan agreement and on each anniversary date thereof, that it is a qualified recipient described in paragraph (c)(9) of this section. In addition, the qualified recipient must agree in the loan agreement with the qualified financial institution (or with the financial intermediary, if the loan is made through a financial intermediary):

(A) To use the funds at all times during the period the loan is outstanding solely for the purposes and in the manner described in paragraph (c)(4) of this section (regarding investment in active business assets) or in paragraph (c)(5) of this section (regarding investment in development projects);

(B) To comply with the requirements of paragraph (c)(6) of this section (regarding time periods within which the funds must be invested and temporary investments) and paragraph (c)(7) of this section (regarding the time periods within which funding for investments must be secured and the refinancing of existing funding);

(C) To notify the Assistant Commissioner (International), the qualified financial institution (or the financial intermediary, if the loan is made through a financial intermediary), and the Commissioner of Financial Institutions of Puerto Rico (or his delegate) pursuant to paragraph (c)(14) of this section if it no longer is a qualified recipient or if, for any other reason, the investment has ceased to qualify as a qualified investment described in paragraph (c)(1) of this section, promptly upon the occurrence of such disqualifying event; and

(D) To permit examination by the office of the Assistant Commissioner (International) (or by the office of any District Director authorized by the Assistant Commissioner (International)) and the Commissioner of Financial Institutions of Puerto Rico (or his delegate) of all necessary books and records that are sufficient to verify that the funds were used for investments in active business assets or development projects in conformity with the terms of the loan agreement.

(ii) Certification by a financial intermediary. In the case of a loan by a qualified financial institution to a financial intermediary, the financial intermediary must certify to the qualified financial institution (using the procedures described in paragraph (c)(11)(i) of this section) that it is a financial intermediary described in paragraph (c)(8)(iv)(H) of this section, and must furnish to the qualified financial institution a copy of the qualified recipient's certification described in paragraph (c)(11)(i) of this section and of its loan agreement with the qualified recipient. In addition, the financial intermediary must agree in the loan agreement with the qualified financial institution:

(A) To comply with the requirements of paragraph (c)(8)(iv) of this section; and

(B) To permit examination by the office of the Assistant Commissioner (International) (or by the office of any District Director authorized by the Assistant Commissioner (International)) and the Commissioner of Financial Institutions of Puerto Rico (or his delegate) of all its necessary books and records that are sufficient to verify that the funds were used in conformity with the terms of the loan agreements.

(12) Certification requirements. In order for an investment to be considered a qualified investment under section 936(d)(4), section 936(d)(4)(C)(i) requires that both the person in whose trade or business such investment is made and the financial institution certify to the Secretary of the Treasury and the Commissioner of Financial Institutions of Puerto Rico that the proceeds of the loan will be promptly used to acquire active business assets or to make other authorized expenditures. This certification requirement is satisfied as to the qualified financial institution, the financial intermediary (if any), and the qualified recipient if the qualified financial institution submits a certificate to both the Assistant Commissioner (International) and to the Commissioner of Financial Institutions of Puerto Rico (or his delegate) pursuant to paragraph (c)(14) of this section upon authorization of the investment by the Commissioner of Financial Institutions and, in any event, prior to the first disbursement of the loan proceeds to the qualified recipient or to the financial intermediary (if any), in which the qualified financial institution-

(i) Represents that, as of the date of the certification, the qualified recipient and the financial intermediary (if any) have complied with the requirements described in paragraph (c)(11) of this section;

(ii) Describes the important terms of the loan to the financial intermediary (if any) and to the qualified recipient, including the amount of the loan, the nature of the investment, the basis for its qualification as an investment in active business assets or a development project under this section, the identity of the financial intermediary (if any) and of the qualified recipient, the qualified Caribbean Basin country involved, and the nature of the collateral used, including any guarantee; and

(iii) Agrees to permit examination by the Assistant Commissioner (International) (or by the office of any District Director authorized by the Assistant Commissioner (International)) and the Commissioner of Financial Institutions of Puerto Rico (or his delegate) of all its necessary books and records that are sufficient to verify that the funds were used for investments in active business assets or development projects in conformity with the terms of the loan agreement or agreements with the financial intermediary (if any) and with the qualified recipient.

(13) Continuing due diligence requirements. In order to maintain the qualification for an investment under paragraph (c)(1) of this section, the continuing due diligence requirements described in this paragraph (c)(13) must be satisfied.

(i) Requirements of qualified recipient. A qualified recipient must-

(A) Submit annually to the qualified financial institution or to the financial intermediary from which its qualified funds were obtained a copy of its most recent annual financial statement accompanied by an opinion of its independent auditors

disclosing the amount of the loan, the current outstanding balance of the loan, describing the assets financed with such loan and the qualified business activity in which such assets are used or the development project for which the loan is used, and stating that there are no reasons to doubt that the loan proceeds have been properly used and continue to be properly used, and

(B) Act in a manner consistent with its representations and agreements described in paragraph (c)(11) of this section.

(ii) Requirements of qualified financial institutions. Except as otherwise provided in paragraph (c)(13)(iii) of this section, a qualified financial institution described in paragraph (c)(3) of this section must maintain in its records and have available for inspection the documentation described in paragraph (c)(13)(ii) (A) or (B) of this section. In addition, the qualified financial institution is required to notify the Assistant Commissioner (International) and the Commissioner of Financial Institutions of Puerto Rico (or his delegate) pursuant to paragraph (c)(14) of this section upon becoming aware that a loan has ceased to be an investment in active business assets or a development project under this section. For purposes of this paragraph (c)(13)(ii), multiple loans for investment in a single qualified business activity or development project will be aggregated in determining what due diligence requirements apply.

(A) In the case of a disbursement to a qualified recipient of loan proceeds amounting in the aggregate, at any time, to \$1,000,000 or less, the following documents must be maintained and available for inspection:

(1) The loan application or other similar document;

(2) The financial statements of the qualified recipient filed as part of the loan application;

(3) The statement required by section 6.4.3(a)(iii) of Puerto Rican Regulation No. 3582 or any successor thereof, signed by the qualified recipient (or its duly authorized representative), acknowledging the receipt of the loan proceeds, describing the assets financed with such loan and the business activity in which such assets are to be used or the development project for which the funds will be utilized, the collateral to be provided for the transaction including any guarantee, and the basis for its qualification as a qualified recipient; and

(4) The loan documents, if any.

(B) In the case of a disbursement to a qualified recipient of loan proceeds amounting in the aggregate, at any time, to more than \$1,000,000, the following documents must be maintained and available for inspection, in addition to the documents required by paragraph (c)(13)(ii)(A) of this section:

(1) A memorandum of credit prepared and signed by an officer of the qualified financial institution containing the details of the investigation and review that it conducted in order to evaluate whether the investment is qualified under paragraph (c)(1) of this section and his opinion that there is no reasonable ground for belief that the qualified funds will be diverted to a use that is not permitted under the

provisions of this section; in making this investigation and review, factors that must be utilized are ones similar to those listed in Puerto Rico Regulation No. 3582, section 6.4.2;

(2) The annual financial statement of the qualified recipient; and

(3) The written report of an officer of the qualified financial institution documenting his discussions, both before and after the disbursement of the loan proceeds, with each recipient's accounting, financial and executive personnel with respect to the proposed and actual use of the loan proceeds and his analysis of the annual financial statements of the qualified recipient including an analysis of the statement of sources and uses of funds. After the loan disbursement, such discussions and review shall occur annually during the term of the loan. Such report shall include the conclusion that in such officer's opinion there is no reasonable ground for belief that the qualified recipient is improperly utilizing the funds.

(iii) Requirements in the case of a financial intermediary. Where a qualified financial institution lends funds to a financial intermediary which are on-lent to a qualified recipient -

(A) The obligation to maintain the documentation described in paragraph (c)(13)(ii) (A) or (B) of this section shall apply only to the financial intermediary and not to the qualified financial institution and the provisions of paragraph (c)(13)(ii) (A) or (B) shall be read so as to impose on the financial intermediary any obligation imposed on the qualified financial institution.

(B) The financial intermediary shall forward annually to the qualified financial institution a copy of the documentation it is required to maintain in its records pursuant to the provisions of this paragraph (c)(13)(iii) and shall notify the Assistant Commissioner (International), the Commissioner of Financial Institutions of Puerto Rico (or his delegate), and the qualified financial institution pursuant to paragraph (c)(14) of this section upon becoming aware that a loan has ceased to be an investment in active business assets or a development project under this section. The qualified financial institution must maintain in its records and have available for inspection the copied documentation furnished by the financial intermediary pursuant to this paragraph (c)(13)(iii)(B).

(C) The qualified financial institution shall cause one of its officers to prepare a written report documenting his analysis of the copied documentation furnished by the financial intermediary pursuant to paragraph (c)(13)(iii)(B) of this section, his discussions, both before and after the disbursement of the loan proceeds, with the financial intermediary's accounting, financial and executive personnel with respect to the proposed and actual use of the loan proceeds, and his analysis of the annual financial statements of the qualified recipient including an analysis of the statement of sources and uses of funds. After the loan disbursement, such discussions and review shall occur annually during the term of the loan. Such report shall include the conclusion that in such officer's opinion there is no reasonable ground for belief that the qualified recipient is improperly utilizing the funds.

(14) Procedures for notices and certifications. Notices and certifications to the Assistant Commissioner (International) required under paragraphs (c)(11), (c)(12) and (c)(13) of this section shall be addressed to the attention of the Assistant

Commissioner (International), Office of Taxpayer Service and Compliance, IN:C, 950 L'Enfant Plaza South, SW., Washington, DC 20024. Notices and certifications to the Commissioner of Financial Institutions of Puerto Rico required under paragraphs (c)(11), (c)(12), and (c)(13) of this section shall be addressed as follows: Commissioner of Financial Institutions, GPO Box 70324, San Juan, Puerto Rico 00936.

(15) Effective dates. This paragraph (c) is effective for investments by a possessions corporation in a financial institution that are used by a financial institution for investments in accordance with a specific authorization granted by the Commissioner of Financial Institutions of Puerto Rico after September 22, 1989.

OMB Control Numbers Under the Paperwork Reduction Act

PART 602-[AMENDED]

Par. 3. The authority for part 602 continues to read as follows:

Authority:

26 U.S.C. 7805.

§602.101 [Amended]

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table: "1.936-10T(c)..... 1545-1138."

Fred T. Goldberg, Jr.,

Commissioner of Internal Revenue.

Approved: August 28, 1989.

Kenneth W. Gideon,

Assistant Secretary of the Treasury.