FEDERAL RESERVE BANK

OF DALLAS

Dallas, Texas, April 11, 1966

To All Member Banks in the
Eleventh Federal Reserve District:

Occasionally bank advertising refers to the tax aspects of interest income on certain types of savings certificates issued by banks. The Internal Revenue Service has modified previous rulings relating to the annual reporting of accrued interest. Your bank may be interested in the excerpts from two such recent rulings.

"Rev.Rul. 66-44

"The increment in value of growth savings certificates issued by a bank shall be included in the gross income of a taxpayer employing the cash receipts and disbursements method of accounting in each taxable year in which the increase occurs, since the taxpayer (certificate holder) has a right to redeem the certificate in such taxable year."

"Rev.Rul. 66-45

"Interest on nonnegotiable savings certificates issued by a bank which is not credited periodically to a certificate holder but paid only upon the surrender and redemption of the certificates, is includible in the gross income of the holder, employing the cash receipts and disbursements method of accounting, in each taxable year in which the holder either has the right to redeem the certificate or could have had such right through making written demand for payment."

Rev.Rul. 66-45 refers to nonnegotiable savings certificates; however, it is understood that, although the adjective "nonnegotiable" was used in one ruling, informal advice from the Internal Revenue Service is to the effect that both rulings are equally applicable to negotiable and non-negotiable certificates.

The rulings in their entirety are shown inside of this folder for your convenient reference.

Yours very truly,

Watrous H. Irons
President

SECTION 451.—GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

26 CFR 1.451–2: Constructive receipt of income

Rev.Rul. 66–44

The increment in value of growth savings certificates issued by a bank shall be included in the gross income of a taxpayer employing the cash receipts and disbursements method of accounting in each taxable year in which the increase occurs, since the taxpayer (certificate holder) has a right to redeem the certificate in such taxable year.

Revenue Ruling 57–452, C.B. 1957–2, 302, revoked.

Advice has been requested with respect to constructive receipt of income earned on growth savings certificates issued by a bank.

These growth savings certificates have face amounts greater than the amounts with respect to which they are issued and are redeemable at any time for amounts equal to the issue price plus increments which accrue regularly up to their maturity date. Thus, these certificates are in the nature of deposits.

At one time, such growth savings certificates were regarded as obligations issued at a discount and similar to series E, United States savings bonds. These certificates received tax treatment similar to series E bonds under Revenue Ruling 57–452, C.B. 1957–2, 302, which held that the increase in redemption price (increment in value) during a taxable year did not constitute income in such year to a taxpayer-depositor holding such certificate and employing the cash receipts and disbursements method of accounting. However, the Revenue Ruling permitted the taxpayer to elect, under section 454(a) of the Internal Revenue Code of 1954, to report the increase in the taxable year in which it occurs.

Section 1.451–2(a) of the Income Tax Regulations, as amended by Treasury Decision 6723, C.B. 1964–1 (Part 1), 73, provides that income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year in which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, it also provides that income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

The phrase "or otherwise made available" which was inserted in the first sentence of paragraph (a) of section 1.451–2 of the regulations makes it clear that it is a right of withdrawal during the taxable year, rather than the formal setting apart or crediting of income, which causes such income to be constructively received.

The regulations, as amended, list four specific conditions which do not constitute substantial limitations or restrictions on the taxpayer's control over the receipt of earnings payable in respect of any deposit or account in a "bank or other financial institution," which term includes banks, building and loan associations, savings and loan associations, and Federal savings and loan associations.

Upon reconsideration of the matter, the increment in value of growth savings certificates issued by a bank shall be included in the gross income of a taxpayer, employing the cash receipts and disbursements method of accounting, in each taxable year in which the increase occurs since the taxpayer (certificate holder) has a right to redeem the certificate in such taxable year.

The provisions of Revenue Procedure 64–24, C.B. 1964–1 (Part 1), 693, relating to closing agreements for interest earned on deposits or accounts opened before November 15, 1962, apply to the increment in value of these growth savings certificates.

Revenue Ruling 57–452, C.B. 1957–2, 302, is hereby revoked.

Interest on nonnegotiable savings certificates issued by a bank, which is not credited periodically to a certificate holder but paid only upon the surrender and redemption of the certificates, is includible in the gross income of the holder, employing the cash receipts and disbursements method of accounting, in each taxable year in which the holder either has the right to redeem the certificate or could have had such right through making written demand for payment.

Revenue Ruling 60-145, C.B. 1960-1, 182, modified.

Advice has been requested with respect to the application of section 1.451-2 of the Income Tax Regulations relating to constructive receipt of interest earned on nonnegotiable savings certificates described below.

A bank issued interest-bearing nonnegotiable savings certificates in multiples of $100. The bank agreed to pay the face amount of the certificate, with interest, to the holder at the end of 1 year, provided the holder made written demand for such payment on or before the expiration of such year.

If written demand was not made, the certificate remained in force and was redeemable at the end of each 6-month period thereafter. The bank was obligated to pay the face amount of the certificate, with interest, at the expiration of any such period within which demand for payment was made.

No crediting of interest on this certificate was made until the holder presented it for redemption, at which time the bank paid the face amount and all earned interest. The certificate could be redeemed only at the end of the first year or any subsequent 6-month period within which the holder made demand for payment and surrendered the certificate.

Section 1.451-2(a) of the regulations, as amended by Treasury Decision 6723, C.B. 1964-1 (Part 1), 73, provides that income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year in which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

The phrase "or otherwise made available" was added to the first sentence of paragraph (a) of section 1.451-2 of the regulations to make it clear that it is a right of withdrawal during the taxable year, rather than the formal setting apart or crediting of income, which causes such income to be constructively received.

Section 1.451-2(a) (3) of the regulations provides that a requirement that the earnings may be withdrawn only upon a withdrawal of all or part of the deposit or account is not a substantial limitation or restriction on the taxpayer's control over the receipt of such earnings.

It is further provided in section 1.451-2(a) (4) of the regulations that a requirement that notice be given prior to withdrawal is also not a substantial limitation.

Accordingly, interest on nonnegotiable savings certificates issued by a bank, which is not credited periodically to a certificate holder but paid only upon the surrender and redemption of the certificates, is includible in the gross income of the holder, employing the cash receipts and disbursements method of accounting, in each taxable year in which the holder either has the right to redeem the certificate or could have had such right through making written demand for payment.

The provisions of Revenue Procedure 64-24, C.B. 1964-1 (Part 1), 693, relating to closing arrangements for interest earned on deposits or accounts opened before November 15, 1962, apply to interest on these nonnegotiable savings certificates.

Revenue Ruling 60-145, C.B. 1960-1, 182, to the extent that it is in conflict with the result required by section 1.451-2 of the regulations as explained above, is hereby modified.