

# FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 81-181  
September 15, 1981

## ALL SAVERS CERTIFICATE

TO ALL MEMBER BANKS  
AND OTHERS CONCERNED IN THE  
ELEVENTH FEDERAL RESERVE DISTRICT:

In an attempt to assist member banks in implementing the All Savers Certificates which are authorized beginning October 1, 1981, under the Economic Recovery Tax Act of 1981 (P.L. 97-34), this circular is addressing questions that have been raised concerning the ability of depositors to convert existing time deposits (including six-month money market certificates) to the new tax-exempt All Savers Certificates.

Under Section 217.4(d)(5) of Regulation Q, any outstanding deposit may be converted to an All Savers Certificate or any other deposit at the same institution without imposition of the early withdrawal penalty on the outstanding deposit if:

- (1) the depositor and the member bank agree to a conversion;
- (2) the original maturity of the new deposit is equal to or exceeds the remaining maturity on the outstanding deposit; and
- (3) the rate paid on the new deposit does not exceed the lower of (a) the rate being paid on the outstanding deposit, or (b) the regulatory ceiling rate, if any, applicable to the new deposit category at the time of conversion.

The Board's current rule provides that any amendment of an existing time deposit contract that results in an increase in the rate of interest paid or in a reduction of the maturity of the deposit constitutes a payment of the time deposit before maturity, thereby subjecting such a deposit to the Regulation Q early withdrawal penalty.

The question has been raised concerning the rate that may be paid when a depositor converts a portion of an outstanding money market certificate to an All Savers Certificate if such a conversion results in a money market certificate with a remaining balance of less than \$10,000.

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Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

A member bank may pay the money market certificate rate on a deposit only if the deposit possesses a continuing balance of \$10,000 or more and otherwise satisfies the regulations applicable to money market certificates. If, after conversion of a portion of a money market certificate to another deposit, the remaining balance on the original deposit is not \$10,000 or more, the maximum rate of interest a member bank can pay on the deposit from the day of conversion is the ceiling rate of interest for time deposits of under \$10,000 with maturities equal to the original maturity period of the money market certificate.

If a member bank chooses to lend its depositor the amount needed to bring the remaining money market certificate balance up to \$10,000, and uses the money market certificate as collateral for the loan, Section 217.4(f) of Regulation Q requires that the rate of interest on the loan shall be at least 1 percent per annum in excess of the rate of interest being paid on the money market certificate. Under the Internal Revenue Code, a taxpayer loses the All Savers Certificate Tax exemption if his All Savers Certificate is used as collateral for a loan.

Enclosed are copies of the Depository Institutions Deregulation Committee's press release and rules relating to the issuance of All Savers Certificates by depository institutions and the Internal Revenue Service's News Release and Revenue Ruling regarding the tax consequences of programs that link All Savers Certificates with repurchase agreements and similar investment packages.

Questions regarding the All Savers Certificate should be directed to this Bank's Legal Department, Extension 6171.

Additional copies of the circular will be furnished upon request to the Department of Communications, Financial and Community Affairs of this Bank, Extension 6289.

Sincerely yours,



William H. Wallace  
First Vice President

# DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE PRESS RELEASE

COMPTROLLER OF THE CURRENCY    FEDERAL DEPOSIT INSURANCE CORPORATION    FEDERAL HOME LOAN BANK BOARD  
FEDERAL RESERVE BOARD    NATIONAL CREDIT UNION ADMINISTRATION    TREASURY DEPARTMENT

September 3, 1981

## DIDC ADOPTS ALL SAVERS CERTIFICATE REGULATIONS

The Depository Institutions Deregulation Committee (DIDC) today adopted regulations authorizing depository institutions to issue one-year, tax exempt All Savers Certificates (ASCs).

The DIDC, acting in accordance with the Economic Recovery Tax Act of 1981, stipulated that the ASCs must:

(1) have an annual investment yield equal to 70 percent of the average investment yield for 52-week U.S. Treasury bills;

(2) be offered in denominations of \$500, but can also be offered in any other denominations;

(3) only be issued from October 1, 1981 through December 31, 1982; and

(4) have a maturity of one year.

The ASCs will be subject to existing rules for other types of deposits including rules regarding premiums, early withdrawals, and broker's or finder's fees.

Depository institutions must give ASC buyers notice of the tax implications of interest earned. There is a lifetime exclusion from gross income for interest earned on ASCs of \$1,000 (\$2,000 in the case of a joint return).

A depository institution's executive officer will have to certify that the institution has satisfied the qualified residential and agricultural financing provision required by the Tax Act.

As stated above, the ASCs must have an average investment yield equal to 70 percent of the average investment yield of 52-week U.S. Treasury bills. Normally these are auctioned every four weeks on a Thursday. The average investment yield will be announced with the results of every 52-week bill auction. Seventy percent of this will become the offering yield for all ASCs issued starting Monday of the following week. That offering yield will remain unchanged until the week after the next auction of 52-week Treasury bills four weeks later.

For example, the auction of 52-week U.S. Treasury bills on August 6, 1981 resulted in an average price of 85.296 per 100. The average investment yield on such 52-week bills would be 17.29 percent, 70 percent of which is 12.10 percent. An investor depositing \$1,000 in an ASC subject to this yield requirement would receive \$121.00 in interest upon maturity of the deposit.

Withdrawals of earned interest on ASCs are permitted, but an individual who withdraws interest during the deposit term will receive a lower total amount of interest than if periodic interest earned were left on account and only withdrawn at ASC maturity. This is because the effect of compounding does not take place on any withdrawn interest amounts.

Since ASCs cannot be offered until October 1, 1981, the first auction that will determine the yield on ASC will be the auction on September 3, 1981.

Early Withdrawal: Under existing rules, which also hold for ASCs, the withdrawal of all or part of the principal of an ASC would result in a penalty equal to three months' interest (at the nominal rate) on the amount withdrawn. In addition, the Tax Act provides that an early withdrawal of any portion of the principal will eliminate the tax-exempt status of the ASC.

Premiums: The value of premiums offered to increase the effective yield on ASCs (including shipping, warehousing, packaging and handling costs for merchandise) cannot exceed \$10 for deposits of less than \$5,000 or \$20 for deposits of \$5,000 or more.)

Denominations: An institution is required to accept ASC deposits in multiples of \$500 but may accept deposits in any other amount. It could accept a deposit for \$247, for example, or \$1,386.45 or any other amount.

Commissioner of the IRS, Roscoe L. Egger, Jr., says IRS has reviewed pertinent portions of the DIDC final rules and finds them consistent with the applicable provisions of the Internal Revenue Code.

Contact: Robert Don Levine -- 566-5158  
Marlin Fitzwater -- 566-5252

TITLE 12--BANKS AND BANKING  
CHAPTER XII--DEPOSITORY INSTITUTIONS DEREGULATION COMMITTEE  
PART 1204--INTEREST ON DEPOSITS

Qualified Tax-Exempt Savings Certificates

AGENCY: Depository Institutions Deregulation Committee.

ACTION: Final Rules.

SUMMARY: The Depository Institutions Deregulation Committee ("Committee") has established a new category of time deposit in order to permit depositors to take advantage of the Federal income tax benefits applicable to interest earned on qualified tax-exempt savings certificates, the so-called All-Savers Certificates ("ASCs"), and in order to help depository institutions reduce their costs of funds and increase their deposit flows. The Economic Recovery Tax Act of 1981 ("Tax Act"), with certain restrictions, authorizes a maximum lifetime exclusion of \$1,000 (\$2,000 in the case of a joint return) from gross income for interest earned on ASCs, which (1) are issued from October 1, 1981 through December 31, 1982, (2) have a maturity of one year, (3) are available in denominations of \$500 and any other denomination determined by the depository institution and (4) have an annual investment yield equal to 70 percent of the average investment yield for the most recent auction of 52-week U.S. Treasury bills prior to the calendar week in which the ASCs are issued. The Committee also required that certain notice regarding the tax implications of ASCs be given to a depositor prior to the purchase of an ASC.

EFFECTIVE DATE: October 1, 1981

FOR FURTHER INFORMATION CONTACT: Rebecca Laird, Senior Associate General Counsel, Federal Home Loan Bank Board (202/377-6446), F. Douglas Birdzell or Joseph A. DiNuzzo, Counsels, Federal Deposit Insurance Corporation (202/389-4324 or 389-4237), Daniel Rhoads, Attorney, Board of Governors of the Federal Reserve System (202/452-3711), Allan Schott or Elaine Boutilier, Attorney-Advisors, Treasury Department (202/566-6798 or 566-8737), David Ansell, Attorney, Office of the Comptroller of the Currency (202/447-1880).

SUPPLEMENTARY INFORMATION: Title III of the Tax Act, Public Law 97-34, 95 Stat. 172, (26 U.S.C. §128) provides that up to certain maximum dollar limitations and under certain restrictions, an individual's gross income (for Federal income tax purposes) does not include interest earned on qualified ASCs. In general, the Tax Act authorizes a lifetime exclusion from gross income of \$1,000 for an individual return and \$2,000 for a joint return,

i.e., regardless of how much interest is earned on all ASCs, and regardless of during which taxable years interest on ASCs is earned, no more than a total of \$1,000 (\$2,000 in the case of a joint return) can be excluded from gross income for all taxable years. However, interest earned on a particular ASC may not be excluded from gross income, if (1) any portion of the principal of that ASC is redeemed prior to its maturity, or (2) any portion of that ASC is used as collateral or security for a loan.

In order for interest to qualify for exclusion from gross income under the Tax Act, an ASC must meet several requirements. First, ASCs may be issued only during the period beginning on October 1, 1981, and ending on December 31, 1982. Second, the certificates must have a maturity period of one year. Third, the certificate must have an annual investment yield equal to 70 percent of the average annual investment yield on 52-week Treasury bills. Fourth, the issuing institution must provide that ASCs are available in denominations of \$500.

The Tax Act imposes limitations on the issuing institution with respect to the use of deposit funds derived from ASCs. Generally, for commercial banks, mutual savings banks and savings and loan associations, the Tax Act requires that at least 75 percent of the lesser of: (1) the proceeds from ASCs issued during a calendar quarter or (2) "qualified net savings", be used to provide "qualified residential financing" by the end of the subsequent calendar quarter. If an institution fails to meet the "qualified residential financing" requirement by the end of any calendar quarter, it may not issue additional ASCs until the requirement is satisfied.

The term "qualified net savings" is the amount by which deposits into passbook savings accounts, 6-month money market certificates, 30-month small saver certificates, time deposits of less than \$100,000, and ASCs exceed the amount withdrawn or redeemed from such accounts measured at the beginning and end of each calendar quarter.

"Qualified residential financing" is any of the following:

- (a) Any loan secured by a lien on a single-family or multifamily residence;
- (b) any secured or unsecured qualified home improvement loan;
- (c) any mortgage on a single-family or multifamily residence that is insured or guaranteed by the Federal, State or local government or any instrumentality thereof;

- (d) any loan to acquire a mobile home;
- (e) any loan for the construction or rehabilitation of a single-family or multifamily residence;
- (f) any mortgage secured by single-family or multifamily residences purchased on the secondary market, but only to the extent such purchases exceed sales of such assets;
- (g) any security issued or guaranteed by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or any security issued by any other person if such security is secured by mortgages, but only to the extent such purchases exceed sales of such assets; and
- (h) any loan for agricultural purposes.

The Tax Act defines single-family residence to include stock in a cooperative housing corporation, as defined in section 216 of the Internal Revenue Code, and 2, 3, and 4 family residences.

The Tax Act does not, however, authorize depository institutions to offer ASCs; such determinations were left to the relevant regulatory agencies. In this regard, the Committee is empowered by its enabling statute, The Depository Institutions Deregulation Act (12 U.S.C. §3501 et seq), to prescribe rules governing "the establishment of classes of deposits or accounts", at all Federally insured commercial banks, mutual savings banks and savings and loan associations. In conformance with the provisions of the Tax Act, the Committee has authorized depository institutions to offer non-negotiable ASCs with the following characteristics:

- (1) A maturity of one year,
- (2) Available in denominations of \$500, and
- (3) An annual investment yield equal to 70 percent of the average annual investment yield on 52-week U.S. Treasury bills auctioned immediately preceding the calendar week in which the ASC is issued.

The Tax Act provides that ASCs have a maturity of one year and there is no language in the legislative history or the statute to indicate any flexibility on this question. Accordingly, ASCs must have a maturity of exactly one year. It would be possible, however, for institutions, as part of their contract with depositors, to provide for the automatic renewal of ASCs, just as is permissible for any other time deposit.

The Tax Act states that ASCs are to be "made available in denominations of \$500." There is no language in the statute or its legislative history to indicate that ASCs are to be issued only in denominations of \$500, or only in denominations of \$500 or more. Thus, the Committee has concluded that depository institutions offering ASCs are required to make them available in denominations of \$500, but are permitted to offer ASCs in any other denomination, including denominations of more or less than \$500. However, a depository institution may establish its own maximum deposit amount above \$500. Accordingly, an institution offering ASCs is required to accept ASC deposits for \$500 and may issue them in multiples of \$500, such as \$1,000, \$1,500 and so on, but is not required to accept ASC deposits in other amounts. A depository institution is not required to issue individual certificates for each \$500 of a deposit. At the same time, an institution is permitted to accept ASC deposits in any other amount. For example, a depository institution could accept an ASC deposit in the amount of \$247.00 or \$1,386.45.

With respect to the yield, ASCs must have an annual investment yield to maturity equal to 70 percent of the average investment yield of the most recently auctioned 52-week U.S. Treasury bills. The most recent auction is the one occurring immediately preceding the week in which the ASC is issued. Normally, 52-week U.S. Treasury bills are auctioned every four weeks, on a Thursday. The results of the auction are announced by the Treasury Department late in the day on the auction date. The average investment yield determined by that auction would be applicable for all ASCs issued beginning the next week, which would normally begin on a Monday. Beginning September 3, 1981, the Treasury Department will include the average annual investment yield to maturity for 52-week U.S. Treasury bills (rounded to the nearest one-hundredth of a percentage point) as part of the auction announcement. The annual investment yield should not be confused with the bank discount rate or the investment rate (equivalent coupon-issue yield), both of which are included in the Treasury Department's auction announcement.

Unlike other time deposits regulated by the Committee, the yield on ASCs must be equal to 70 percent of the average annual investment yield on 52-week Treasury bills, rather than be the maximum permissible rate payable on such deposits. Thus, all depository institutions must provide the same yield to maturity on ASCs and there is no differential in favor of thrift institutions. Since the yield on ASCs must be equal to 70 percent of the yield on 52-week U.S. Treasury bills determined at a specific auction, ASCs are fixed-rate instruments.

At their discretion Institutions may credit interest earned periodically during the term of an ASC deposit. Periodic crediting, however, would require that the nominal interest rate be decreased with increased periodicity of



compounding. The total amount of interest credited on ASCs at maturity will not vary with different methods of compounding, provided that no interest is withdrawn during the term of the deposit. Withdrawals are permitted, but an individual who withdraws interest during the deposit term will receive a lower total amount of interest than if periodic interest earned were left on account and only withdrawn at ASC maturity, because the effect of compounding does not take place on any withdrawn interest amounts.

The auction of 52-week U.S. Treasury bills on August 6, 1981, resulted in an average price of 85.296 per 100. The annual investment yield on such 52-week bills would be 17.29 percent, 70 percent of which, 12.10 percent, would be the annual investment yield that institutions are required to pay on ASCs. An investor depositing \$1,000 in an ASC subject to this yield requirement must receive \$121.00 in interest upon maturity of the deposit if all principal and any interest credited by compounding is maintained on deposit for the entire one-year term of the certificate. If, however, an institution permits a depositor to withdraw interest prior to maturity, the amount of interest paid at any given time may only be that amount then credited to the depositor's account based on the periodicity of compounding employed. Accordingly, institutions paying or crediting interest on a quarterly basis in the above illustration would pay \$28.97 per quarter, which is an annualized nominal interest rate of 11.59 percent. Such interest, if left in the account and compounded quarterly, would accumulate to \$121.00 at the end of the one-year term of the certificate. Similarly, monthly payments of interest would be \$9.56 at a nominal rate of 11.48 percent. Different payments or crediting of interest would have to be adjusted accordingly. 1/

1/ The formula used to derive the nominal interest rate at which interest can be paid and credited is as follows:

$$I = \left(1 + \frac{c}{100}\right)^{d/365} - 1$$

$$r = 100 \times \frac{365}{d} \times I$$

where: c = the annual investment yield required to be paid on the ASCs (in percent per annum);

d = the average number of days in a compounding period (365 day year)

I = the amount of interest that can be paid during a compounding period per dollar on balance in the account at the beginning of said period; and

The Committee has also determined that all of its other rules relating to time and savings deposits are applicable to ASCs. For example, interest may be paid to a depositor prior to maturity of the ASC, provided that interest is not prepaid as provided in the Committee's rules (12 C.F.R. §§1204.101 and 1204.111). In addition, the withdrawal of any portion of the ASC (although not the interest earned on the ASC) would result in imposition of an early withdrawal penalty equal to 3 months interest at the nominal interest rate on the amount withdrawn. (12 C.F.R. §1204.103). Furthermore, any brokers' or finders' fees paid in connection with an ASC must be included as part of the yield on the deposit (12 C.F.R. §1204.110).

With respect to premiums, questions have been raised regarding the permissibility of offering premiums for ASC deposits because of a discussion which took place on the floor of the House of Representatives during consideration of the Tax Act (See Congressional Record, July 29, 1981, page H 5139). In that discussion, it was concluded that "substantial premiums or other inducements" should not be used to increase the yield on ASCs. The Committee previously determined that, within certain limitations, premiums given to attract deposits are considered promotional or advertising expenses rather than the payment of interest. For the same reason, the Committee has determined that premiums, under existing limitations, should not be viewed as increasing the yield on ASCs. Thus, premiums may be offered in connection with ASCs under the limitations of the Committee's existing rules (12 C.F.R. §1204.109).

In order to avoid any misunderstandings regarding the tax consequences of the interest earned on a particular ASC, the Committee required depository institutions to provide customers with the following notice prior to the issuance of an ASC:

"The Economic Recovery Tax Act of 1981 authorizes a maximum lifetime exclusion from gross income for Federal income tax purposes of \$1,000 (\$2,000 in the case of a joint return) for interest earned by

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(Footnote 1/con't.)

r = the corresponding nominal rate of interest  
(365-day basis, in percent per annum).

For institutions using continuous compounding, the nominal interest rate would be defined as:  $r = 100 [\ln (1 + (c/100))]$ , where "ln" signifies the natural logarithm of the expression that follows it.

individuals on tax-exempt savings certificates. Regardless of how much interest is earned on this or any other tax-exempt savings certificate, including interest earned on such certificates from other institutions, and regardless of during which taxable years that interest is earned, no more than a total of \$1,000 (\$2,000 in the case of a joint return) can be excluded from federal gross income for all taxable years. Furthermore, interest earned on a specific certificate cannot be excluded from federal gross income if (1) that certificate is used as collateral for any loan, or (2) any part of the principal of that certificate is redeemed or disposed of prior to maturity.

The notice is intended to indicate to depositors that they have ultimate responsibility for the tax consequences of an ASC.

Several requests were submitted to the Committee asking that depositors with six-month money market certificates be permitted to convert their deposits to ASCs, without imposition of any early withdrawal penalty. Because the Federal Reserve Board, Federal Deposit Insurance Corporation and Federal Home Loan Bank Board under their respective individual authorities have already addressed the circumstances under which existing deposits may be converted to ASCs, the Committee has determined that it is not necessary for the Committee to act on the requests.

Also, in order to avoid any confusion or uncertainty with respect to certain terms which are used in the Tax Act, the Committee has made interpretations of such terms. First, the Committee has defined the term "qualified net savings" to include any interest or dividends credited to deposit accounts, since such interest is part of each customer's deposit funds.

Second, the aggregate amount of "qualified residential financing" that a depository institution is to have invested at the end of a relevant quarter is to be determined net of repayments and paydowns of such assets over the relevant quarter, but sales of such assets may not be netted. Thus, an institution is not required to reinvest all of the previous quarter's mortgage loan payments of principal in addition to the requisite amount of the "qualified net savings" or ASCs for the previous quarter. For example, suppose that during quarter one, qualified net savings increased by \$1,500,000--resulting in a requirement that qualified residential financing be increased in quarter two by \$1,125,000 (75 percent of \$1,500,000). Suppose also that the depository institution ended quarter one with \$5,000,000 of qualified residential

financing assets, during quarter two had repayments of principal and complete payoffs of qualified residential financing assets of \$750,000 and qualified residential financing asset sales of \$500,000. To meet its qualified residential financing requirement for quarter two of \$1,125,000, the institution would be required to have outstanding at the end of quarter two qualified residential assets of at least \$5,375,000 (\$5,000,000 plus \$1,125,000 minus \$750,000). That is, in addition to the required investment in qualified residential financing of 75 percent of last quarter's qualified net savings, the institution would have to make up by the end of the current quarter any sales of qualified residential financing assets during that quarter. It would not have to make up the current quarter's amortization of qualified residential financing from principal repayments and paydowns. If the latter had to be reinvested, qualified residential investment in a quarter would exceed 75 percent of the previous quarter's qualified net savings.

Third, the Tax Act does not provide a definition of the term "loan for agricultural purposes" and the legislative history does not provide guidance on the matter. In such circumstances, the Committee determined to establish a definition on the basis of analogous terms described in the instructions to the Call Report for Insured Commercial Banks. Accordingly, a "loan for agricultural purposes" is defined to include all "loans to finance agricultural production and other loans to farmers" (Schedule A, item 4) and "real estate loans secured by farmland" (Schedule A, item 1(b)). Finally, the exigencies of the housing finance business may make it extremely difficult for depository institutions actually to make investments in eligible loans within the quarter for which the qualified residential financing requirement is determined. Many mortgages close more than three months after the loan commitment is made and construction loan disbursements may be spread over several quarters. Since fulfillment of a commitment would achieve the desired residential financing, the Committee has determined that a firm commitment to make a loan that is described in the Tax Act as "qualified residential financing" will be treated as a qualified investment in the quarter the firm commitment is made.

Under the Tax Act, failure to comply with the qualified residential financing requirement for any calendar quarter precludes an institution from issuing ASCs during the next quarter until the requirement is satisfied. The Committee has determined to enforce this requirement through a certification procedure. An executive officer of the depository institution is to certify that the institution has complied with the qualified residential financing requirement, as set out in the Tax Act. A specific certification form is not required, but it should include appropriate documentation, as determined by the depository institution. In addition, if institutions provide for automatic renewal of an ASC, depositors should be

notified in writing at least 15 days in advance of the maturity date in the event the depository institution cannot renew the ASC because of its failure to satisfy the residential financing requirement.

Because immediate action is necessary to implement a program determined to be in the nation's interest by the Congress, and because of limitations on the Committee's discretionary authority, the Committee has not made any findings under the Regulatory Flexibility Act (5 U.S.C. §601 et. seq.). For the same reason, the Committee finds that the prior notice opportunity for public comment and deferred effective date provisions of 5 U.S.C. §553 are not necessary in taking this action and that good cause exists for not complying with those provisions or the publication provisions of section 1201.6 of the Committee's regulations (12 C.F.R. §1201.6).

Pursuant to its authority under the Depository Institutions Deregulation Act (12 U.S.C. §3501 et. seq.), the Committee amends part 1204 -- Interest on Deposits (12 C.F.R. Part 1204) by adding a new section 116, to read as follows:

§1204.116---Tax-Exempt Savings  
Certificates.

(a) A commercial bank, savings and loan association, or mutual savings bank may pay interest on a non-negotiable tax-exempt savings certificate ("ASC") provided that the time deposit has an original maturity of exactly one year, is available in denominations of \$500 and any other denomination at the discretion of the depository institution, and has an annual investment yield to maturity equal to 70 percent of the average annual investment yield on the most recent auction of 52-week U.S. Treasury bills prior to the calendar week in which the ASC is issued.1/

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1/ When institutions credit interest more frequently than annually, the computation of interest must be adjusted to reflect the effects of compounding so that the annual investment yield to the depositor remains at the rate stipulated by law. Specifically, the formula used to derive the nominal interest rate at which interest can be credited is as follows:

$$I = \left(1 + \frac{c}{100}\right)^{d/365} - 1$$
$$r = 100 \times \left(\frac{365}{d}\right) \times I$$

(b) A depository institution must provide each depositor the following notice, in a form that the depositor may retain at the time of opening a deposit under this subsection:

The Economic Recovery Tax Act of 1981 authorizes a lifetime exclusion from gross income for federal income tax purposes of up to \$1,000 (\$2,000 in the case of a joint return) for interest earned on tax-exempt savings certificates. Regardless of how much interest is earned on this or any other tax-exempt savings certificate, including interest earned on such certificates from other institutions, and regardless of during which taxable years that interest is earned, no more than a total of \$1,000 (\$2,000 in the case of a joint return) can be excluded from federal gross income for all taxable years. Furthermore, interest earned on a specific certificate cannot be excluded from federal gross income if (A) that certificate is used as collateral for any loan, or (B) any part of the principal of that certificate is redeemed or disposed of prior to maturity.

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(Footnote 1/con'td.)

where: c = the annual investment yield required to be paid on the ASCs (in percent per annum);  
d = the average number of days in a compounding period (365 day year);  
I = the amount of interest earned during a (365 day year) compounding period per dollar in the account at the beginning of the period; and  
r = the corresponding nominal rate of interest (365-day basis, in percent per annum).

For institutions using continuous compounding, the nominal interest rate would be defined as:  $r = 100 [\ln (1 + (c/100))]$ , where "ln" signifies the natural logarithm of the expression that follows it.

(c) (1) A depository institution may not issue ASCs after March 31, 1982, under this section unless an executive officer of the depository institution certifies, in a form determined by the institution, that the institution has complied with the "qualified residential financing" requirement set out in 26 U.S.C. §128. The certification must be maintained by the institution in its files and must be available to the institution's primary supervisory agency upon request. The certification shall include appropriate supporting documentation, as determined by the depository institution.

(2) A depository institution issuing ASCs during any calendar quarter must use at least 75 percent of the lesser of:

(a) the proceeds from ASCs issued during a calendar quarter, or

(b) "qualified net savings",

to provide "qualified residential financing" by the end of the subsequent calendar quarter and may not issue additional ASCs until the 75 percent requirement is satisfied.

(3) For purposes of determining compliance with the "qualified residential financing" requirement, the following applies:

(A) the term "qualified net savings" includes interest or dividends credited to deposit accounts;

(B) the amount of "qualified residential financing" is to be determined net of repayment of principal and paydowns, but sales of such assets may not be netted;

(C) the term "any loan for agricultural purposes" is defined to have the same meaning as items described in the instructions to the Report of Condition of all Insured Commercial Banks, schedule A, item 4 "Loans to Finance Agricultural Production and Other Loans to Farmers, and schedule A, item 1(b) "Real Estate Loans Secured by Farmland", and

(D) "qualified residential financing" includes a firm commitment to purchase any assets eligible for such investment.

(d) If a depository institution provides for automatic renewal of an ASC, depositors must be notified in writing at least 15 days in advance of the maturity of an ASC in the event the depository institution cannot renew the ASC because of its failure to satisfy the residential financing requirement. Failure to give such notice shall not result in automatic renewal of the ASC.

(e) This section expires January 1, 1983.

By Order of the Committee, September 3, 1981.

Gordon Eastburn  
Gordon Eastburn  
Acting Executive Secretary



# News Release

## Department of the Treasury Internal Revenue Service

Public Affairs Division  
Washington, DC 20224

For Release: 11:00 a.m.  
9/3/81

Media Contact: Tel. (202) 566-4024  
Copies: Tel. (202) 566-4054  
IR-81-101

Washington, D.C. -- The Internal Revenue Service today announced a ruling on "All Savers' Certificates" to aid purchasers in determining the tax status of interest received and to assist depository institutions participating in the program.

The Economic Recovery Tax Act of 1981 excludes from tax up to \$1,000 of interest, \$2,000 on a joint return, from qualifying one-year "All Savers' Certificates" issued during the period October 1, 1981, through December 31, 1982. Qualifying certificates must have a maturity of one year and have an investment yield equal to 70 percent of the yield on 52-week Treasury bills issued before the certificate issue date.

On August 29, 1981, the IRS responding to statements in advertisements by some financial institutions announced that it had substantial doubt as to the income tax consequences of certain investment packages that specifically link high-yield, short-term investments with the "All Savers' Certificates". The announcement also said the IRS was studying the issue and shortly would announce its findings.

In issuing its earlier announcement and today's ruling the IRS is interpreting the provisions of the Act relating to "All Savers' Certificates" in a manner consistent with the Congressional intent to limit the interest rate that depository institutions are authorized to pay.

The IRS, in announcing its ruling, emphasized that "All Savers' Certificates" whose purchase is not contractually linked to any other investments or benefits qualify for the tax-free interest benefit provided for under the 1981 Act. In any situation, however, where purchase of an "All Savers' Certificate" entitles the purchaser to benefits not available to non-purchasers, purchasers are receiving an amount in excess of that permitted in the law. Accordingly, the certificate does not qualify for the exclusion.

For those taxpayers who have already purchased investment packages that require the reinvestment of the funds from a repurchase agreement into an "All Savers' Certificate", the ruling holds that these certificates will not qualify for the tax-free interest benefit. However, the benefit is restored and the certificate will qualify if the financial institution gives the purchaser a reasonable and realistic opportunity to recover the principal and interest from the repurchase agreement at maturity without penalty.

Similarly, by eliminating any penalty for failure to re-invest the funds from a repurchase agreement in an "All Savers' Certificate", the financial institution can restore the tax-free benefit to purchasers of financial packages that carry a penalty provision.

The IRS also stressed that the interest from any investments linked with "All Savers' Certificates" is taxable income.

Revenue Ruling 81-218, attached, addresses nine fact situations concerning "All Savers' Certificates". Further guidance will be made available through the issuance of regulations and, if necessary, additional rulings.

Rev. Rul. 81-218 will also be published in Internal Revenue Bulletin No. 1981-37 on September 14, 1981.

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## Part I

Section 128.--Interest on Certain Savings Certificates (Also Sections 6049(a)(1), 6652(a)(1); 1.6049-1, 301.6652-1(a)(1)(iii)).  
Rev. Rul. 81-218.

### ISSUE

Do the "All Savers' Certificates" made available to individual taxpayers under the situations described below qualify as depository institution tax-exempt savings certificates, the interest on which, subject to applicable dollar limitations, is exempt from federal income tax under section 128 of the Internal Revenue Code, as added by the Economic Recovery Tax Act of 1981, Pub. Law No. 97-34, section 301, 95 Stat. 172?

### FACTS

Situation 1. On October 1, 1981, A, an individual taxpayer, purchases for \$500 an All Savers' Certificate from a qualified institution. All Savers' Certificates are certificates issued by qualified institutions after September 30, 1981, and before January 1, 1983, having a maturity of 1 year, and an investment yield equal to 70 percent of the average investment yield for the most recent auction of United States Treasury bills with maturities of 52 weeks. These certificates are available in denominations of \$500 and such other denominations as are authorized by depository institution regulatory agencies. All Savers' Certificates are insured by government agencies and pay interest at such intervals as are authorized by depository institution regulatory agencies. At maturity, A will receive all principal and any accrued but unpaid interest on the All Savers' Certificate.

Situation 2. On September 10, 1981, B, an individual taxpayer, enters into a repurchase agreement with Z, a qualified institution. Generally, a repurchase agreement is an arrangement between a customer and a financial institution under which the customer buys certain securities from the institution that the institution agrees to repurchase from the customer at a higher price on a certain date in the future. The repurchase agreement, which is generally available to Z's customers, provides that Z will repurchase the securities from B at a price which will provide B an annual rate of interest on B's funds of 25 percent until October 1, 1981. The agreement between Z and B also provides that funds from the repurchase agreement will automatically be reinvested in an All Savers' Certificate on October 1, 1981, unless B gives instructions to Z at any time prior to that date either to remit B's funds on October 1, 1981, or to have B's funds reinvested on that date in other investments offered by Z. B may elect, without penalty, to have his funds remitted on October 1, 1981, or reinvested on that date.

Situation 3. On October 1, 1981, C, an individual taxpayer, enters into a repurchase agreement with Y, a qualified institution. Y's agreement with C provides that Y will repurchase the securities from C at such a price as to provide C an annual rate of interest on C's funds of 15%, until November 1, 1981, if C elects on or before November 1, 1981, to reinvest in an All Savers' Certificate. Alternatively, Y's agreement provides that Y will repurchase the

the securities at such a price as to provide C an annual rate of interest of only 12% until November 1, 1981, if C does not elect to reinvest in an All Savers' Certificate. On November 1, 1981, C elects to reinvest in an All Savers' Certificate.

Situation 4. On August 17, 1981, D, an individual taxpayer, enters into a repurchase agreement with X, a qualified institution. The repurchase agreement provides that X will repurchase the securities from D at such a price as to provide D an annual rate of interest on D's funds of 30% until October 1, 1981. X's agreement with D further provides that on October 1, 1981, D's funds will automatically be reinvested in an All Savers' Certificate, without any other investment option being made available to D. X's repurchase agreements that provide an annual rate of interest of 30% are not available to taxpayers who do not agree to automatic reinvestment in an All Savers' Certificate.

Situation 5. On October 1, 1981, E, an individual taxpayer, purchases an All Savers' Certificate issued by W, a qualified institution. W's agreement with E provides that upon maturity of the All Savers' Certificate, the amount on account will, at E's option, either be remitted to E or will be used to enter into a repurchase agreement which will provide interest to E on E's funds at the annual rate of 25% for a 60 day period. The option to enter into future repurchase agreements with W providing such a return is not available without charge to taxpayers who do not agree to purchase an All Savers' Certificate.

Situation 6. On October 1, 1981, F, an individual taxpayer, purchases from V, a qualified institution, an All Savers' Certificate and enters into a 30-day repurchase agreement, which will provide a return to F on F's funds at the annual interest rate of 25%, over the 30-day period. V's repurchase agreements that provide such a return are not available to taxpayers who do not simultaneously purchase an All Savers' Certificate.

Situation 7. On October 1, 1981, G, an individual taxpayer, purchases from U, a qualified institution, an All Savers' Certificate for \$10,000. In advertisements, U has offered to waive certain standard loan origination fees or to charge a reduced rate of interest on consumer or mortgage loans made to purchasers of All Savers' Certificates in denominations over \$10,000.

Situation 8. On October 1, 1981, H, an individual taxpayer, purchases from T, a qualified institution, an All Savers' Certificate for \$4,000. In addition, H receives from T a premium of the type not regarded as interest under applicable depository institution regulations. The value of the premium does not exceed the amount regarded as de minimis under existing depository institution regulations.

Situation 9. On August 26, 1981, J purchases for \$10,000 a six-month money market certificate with an annual interest rate of 16.104% from S, a qualified institution. On October 1, 1981, J "rolls over" the principal and accumulated interest from the money market certificate, without penalty, into an All Savers' Certificate. Assume that the auction of 52-week U.S. Treasury

bills in the week before October 1, 1981, results in an average annual investment yield on such bills of 17.29%, 70% of which, or 12.10%, would be the annual investment yield on the 'All Savers' Certificate.

#### LAW AND ANALYSIS

Section 128(a) of the Code provides that gross income does not include any amount received by any individual during the taxable year as interest on a depository institution tax-exempt savings certificate.

Section 128(b) of the Code provides that the amount excludable from an individual's income under section 128(a) in any taxable year shall be limited to the excess of \$1,000 (\$2,000 in the case of a joint return) over the aggregate amount excludable by the individual for prior taxable years.

Section 128(c) of the Code provides that the term "depository institution tax-exempt savings certificate" means any certificate that (A) is issued by a qualified institution after September 30, 1981, and before January 1, 1983, (B) has a maturity of 1 year, (C) has an investment yield equal to 70 percent of the average investment yield for the most recent auction (before the week in which the certificate is issued) of United States Treasury bills with maturities of 52 weeks, and (D) is made available in denominations of \$500.

Section 6049(a)(1) of the Code provides that every person who makes payments of interest aggregating \$10 or more to any other person during any calendar year must file an information return reporting the payments. Section 6049(b) defines interest to include



interest on deposits made with persons carrying on the banking business and amounts paid by a mutual savings bank, savings and loan association, cooperative bank, homestead association, credit union, or similar organization.

In Situation 1, the All Savers' Certificate meets the requirements of section 128 of the Code and the interest exclusion is available.

In Situation 2, because B has a realistic opportunity to have the funds from the repurchase agreement remitted or reinvested without penalty on October 1, 1981, B can have the benefit of the higher yield repurchase agreement without agreeing to purchase the All Savers' Certificate. Accordingly, the repurchase agreement and All Savers' Certificate are independent investments, the All Savers' Certificate meets the requirements of section 128 of the Code, and the interest exclusion is available.

In Situation 3, C can only have the benefit of the higher yield repurchase agreement by agreeing to purchase an All Savers' Certificate. The repurchase agreement and All Savers' Certificate are contractually linked and, for purposes of section 128 of the Code, are treated as one investment with a maturity in excess of one year and an investment yield in excess of 70% of the average investment yield for the most recent auction of United States Treasury bills with maturities of 52 weeks. The certificate fails to satisfy

either the maturity or yield requirements of section 128(c) of the Code and the interest exclusion is not available.

In Situations 4, 5, 6 and 7, benefits are made available to purchasers of All Savers' Certificates that are not made available to other individuals, thus linking these benefits to purchase of such certificates. By purchasing their All Savers' Certificates, D, E, F, and G, respectively, receive benefits in excess of 70% of the average investment yield for the most recent auction of United States Treasury bills with maturities of 52 weeks. Further, in Situation 4, the investment has a maturity of more than one year. Therefore, the requirements of section 128 of the Code are not met in Situations 4, 5, 6 and 7, and the interest exclusion is not available.

In Situation 8, the premium received by H has a de minimis value that is not regarded as interest under applicable depository institution regulations. As a matter of administrative convenience, such nominal premiums will not be included in determining the investment yield of All Savers' Certificates. Accordingly, the All Savers' Certificate meets the requirements of section 128 of the Code and the interest exclusion is available.

In Situation 9, under the current rules of depository institution regulatory agencies, a "roll over" from a six-month money market certificate into a deposit contract having a lower or equal interest rate and a longer or equal term does not subject the taxpayer to a penalty. Further, any individual who purchases a six-month

money market certificate always has the option of holding the certificate to maturity or of "rolling over" the certificate without penalty into other deposit contracts under regulatory agency rules of general applicability. Accordingly, since the two investments are not contractually linked, and since J's purchase of an All Savers' Certificate does not entitle him to benefits not generally available to other individuals, the All Savers' Certificate meets the requirements of section 128 of the Code and the interest exclusion is available.

#### HOLDINGS

The All Savers' Certificates described in Situations 1, 2, 8 and 9 qualify as depository institution tax-exempt savings certificates and the interest paid thereon is exempt from federal income tax under section 128 of the Code, subject to the limitations therein prescribed. The All Savers' Certificates described in Situations 3, 4, 5, 6 and 7 do not qualify as depository institution tax-exempt savings certificates and the interest paid thereon is not exempt from federal income tax under section 128.

Further, issuers of All Savers' Certificates must report on Forms 1096 and 1099, in accordance with the accompanying instructions, all payments of interest over \$10, even though the recipient of the interest income may be able to exclude all or part of the interest from income. Failure to file the requisite forms could subject the payer to a penalty under section 6652(a)(1) of the Code for each failure.