

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **9130**]
[August 21, 1981]

ELIGIBILITY CRITERIA FOR NOW ACCOUNTS

Interpretation of Regulation Q

*To All Depository Institutions, and Others Concerned,
in the Second Federal Reserve District:*

The Board of Governors of the Federal Reserve System has adopted a clarification of its rules on the eligibility of depositors to hold interest-bearing checking accounts at member banks.

The following is quoted from the text of the Board's announcement:

The interpretation affects eligibility for Negotiable Order of Withdrawal (NOW) accounts authorized nationwide by the Consumer Checking Account Equity Act of 1980. The Board acted after considering comment received on a proposal published April 14, 1981.

The interpretation of Regulation Q, effective September 1, 1981, permits the following depositors to establish NOW accounts at member banks:

1. All individuals, including businesses operated as sole proprietorships. (Only these individuals and sole proprietorships will continue to be eligible to hold Automatic Transfer Service (ATS) accounts.)
2. Non-profit organizations described in specified sections of the Internal Revenue Code.
3. Government units, if the funds are in the name of or are used for the purposes of schools, colleges, universities, libraries, hospitals or other medical or educational facilities.

The Board also ruled that currently permissible NOW accounts that would no longer qualify under the revised eligibility standards, and that were established before September 1, 1981, will be permanently grandfathered.

Enclosed — for depository institutions in this District — is the text of the Board's official notice of the interpretation, including the text of the Internal Revenue Code sections referred to above. It will be published in the *Federal Register*, and copies will be furnished by our Circulars Division upon request.

Questions on this matter may be directed to our Consumer Affairs and Bank Regulations Department (Tel. No. 212-791-5914).

ANTHONY M. SOLOMON,
President.

TITLE 12 -- BANKS AND BANKING

CHAPTER II -- FEDERAL RESERVE SYSTEM

SUBCHAPTER A -- BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Regulation Q]

(Docket No. R-0356)

PART 217 -- INTEREST ON DEPOSITS

Depositors Eligible to Maintain NOW Accounts

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final interpretation.

SUMMARY: The Board of Governors has issued an interpretation of Regulation Q--Interest on Deposits (12 CFR Part 217) to clarify the rules concerning the class of depositors eligible to maintain NOW accounts at member banks. Under the interpretation, the class of depositors eligible to maintain NOW accounts at member banks will include: (1) all individuals, including sole proprietorships, and trust or fiduciary accounts in which the entire beneficial interest is held by individuals; (2) nonprofit organizations that are described in sections 501(c)(3) through (13) and (19), and 528 of the Internal Revenue Code; and (3) governmental units, if the funds are in the name of or are used for the purposes of schools, colleges, universities, libraries, hospitals or other medical facilities. However, businesses operated for profit organized as partnerships, corporations or other associations, and most governmental units will not be permitted to maintain NOW accounts. Depositors that established NOW accounts at member banks on or before August 31, 1981, that are eligible under existing criteria may continue to maintain those accounts even if they would no longer be eligible under the revised rules for eligibility. The Board believes that the eligibility criteria for NOW accounts will be more understandable as a result of this action and will reduce substantially the need for Board review of individual questions of eligibility.

EFFECTIVE DATE: September 1, 1981.

FOR FURTHER INFORMATION CONTACT: Gilbert T. Schwartz, Associate General Counsel (202/452-3625), or Paul S. Pilecki, Senior Attorney (202/452-3281), Legal Division, Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

[Enc. Cir. No. 9130]

SUPPLEMENTARY INFORMATION: The Consumer Checking Account Equity Act of 1980 (Title III of Pub. L. 96-221) ("Act") authorized depository institutions nationwide (except credit unions which are authorized to offer share draft accounts) effective December 31, 1980, to permit the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties (12 U.S.C. § 1832(a)(1)). Under the statute, NOW accounts are available only to individuals and to qualifying organizations (12 U.S.C. § 1832(a)(2)). Qualifying organizations must meet two separate tests of eligibility. First, they must be operated primarily for "religious, philanthropic, charitable, educational, or other similar purposes;" second, they must not be operated for profit. The Federal Reserve previously has advised member banks that the class of depositors eligible to hold NOW accounts is virtually identical to the class of depositors eligible to hold savings deposits without limit (with the exception of governmental units).^{1/}

Since the passage of the Act, the Federal Reserve has received a significant number of requests from member banks and their customers for rulings and opinions concerning NOW account eligibility. In many instances these requests have required the consideration of subtle distinctions that are not altogether practical for application on a uniform basis by a large number of depository institutions. In order to alleviate problems that have arisen among member banks concerning the class of depositors eligible to hold NOW accounts, the Board on April 14, 1981, requested public comment (46 Fed. Reg. 22600) on a proposed interpretation of Regulation Q to simplify and clarify the rules concerning NOW account eligibility.

Under the proposal, the class of depositors eligible to maintain NOW accounts at member banks would have included: (1) individuals, if the funds are not used primarily for business purposes, (2) nonprofit organizations that are described in sections 501(c)(3) through (13) and (19) and 528 of the Internal Revenue Code, and (3) governmental units, if the funds are in the name of and used for the purposes of schools, colleges, universities, libraries, hospitals or other medical facilities. However, under the proposal, businesses that are operated for profit, including sole proprietorships, partnerships, corporations, and other organizations, and most governmental units would not have been permitted to maintain NOW accounts. In addition, all NOW accounts that met the current NOW account eligibility criteria but would not be eligible under the new criteria could have continued to have been maintained, but only until December 31, 1981.

^{1/} Regulation Q explicitly permits fraternal organizations to maintain NOW accounts; however, the statute omits such group from the list of eligible NOW account depositors. Since the statutory provisions were based on Regulation Q, it is believed that the omission of the term "fraternal" was unintentional and without significance. The Board believes that such organizations are operated for purposes "similar" to "religious, philanthropic, charitable, [and] educational" organizations.

The period for public comment on the NOW account proposal ended on June 15, 1981. Comments were received from more than 800 respondents, primarily depository institutions. Commentators generally agreed with the proposed treatment of nonprofit organizations and governmental units. However, the comments strongly opposed modifying the NOW account eligibility criteria to exclude the funds of individuals operating businesses as sole proprietors or individual farmers and slightly opposed the phaseout of existing NOW account holders that would no longer be eligible to maintain NOW accounts. After consideration of the comments received from the public, the Board has adopted an interpretation concerning eligibility of depositors to maintain NOW accounts at member banks, as discussed below, effective September 1, 1981.^{2/}

Under the Board's interpretation, all organizations, partnerships, corporations, and associations that are not operated for profit and are described in section 501(c)(3) through (13) and (19) and section 528 of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) § 501(c)(3) through (13), (19) and § 528) will be eligible to maintain NOW accounts at a member bank. In this regard, the Act extends NOW account eligibility to organizations not operated for profit if they are operated primarily for religious, philanthropic, charitable, educational or for other similar purposes. The Board believes that virtually all nonprofit organizations described in the cited Internal Revenue Code provisions can be regarded as being operated primarily for purposes that are similar in nature to religious, philanthropic, charitable, or educational purposes and that such provisions are comprehensive with respect to describing such organizations. The Board believes that this interpretation will facilitate compliance by depository institutions and will reduce greatly the need for individual rulings on NOW account eligibility.

Prior to opening a NOW account for a nonprofit organization, a member bank will be required merely to establish that the organization opening the account is an entity described under one of the appropriate provisions of the Internal Revenue Code. This can be accomplished by direct reference to the Code provisions or through the presentation of an exemption determination obtained from the Internal Revenue Service (IRS) (or an opinion of counsel) indicating that the organization is described under section 501(c)(3) through (13) or (19), or section 528. An organization will not be required to actually have obtained an exemption determination from the IRS, but will be required only to be described in one of the designated Code provisions in order to qualify for a NOW account. In any event, significant numbers of organizations have obtained such determinations, and the Board believes that documentation of an organization's status under the Code should be conveniently available to the institution at which the NOW account is opened.

^{2/} In accordance with section 604 of the Regulatory Flexibility Act (5 U.S.C. § 604; Pub. L. 96-354), a final regulatory flexibility statement is available from the Board's Freedom of Information Office (202/452-2407).

The Board has had a longstanding interpretation (1936 Federal Reserve Bulletin 120) which provides that deposits of funds of an individual used in his or her business, i.e. a sole proprietor, may be classified as savings deposits since the Board viewed it as impracticable to distinguish between funds of an individual used in a business and other funds of the individual. (However, funds of a corporation owned solely by an individual may not be held as NOW accounts since the corporation exists separate and apart from the individual.) This ruling has been extended to apply also to eligibility for NOW accounts and the automatic transfer service (ATS). The Board believes that continuation of the policy of permitting deposits of businesses owned by individuals to be held as NOW accounts is appropriate in light of the potential problems--discussed by those commenting on the proposal--that would occur if sole proprietors were prohibited from having NOW accounts. Consequently, all sole proprietorships and other businesses operated by individuals will continue to be eligible to maintain NOW and ATS accounts at member banks. However, the class of depositors eligible to hold NOW accounts will continue to exclude other entities organized or operated to make a profit regardless of whether they are corporations, partnerships, associations, or any other organization.

At present, certain governmental units are eligible for NOW accounts at member banks. These entities include independent school districts and state universities, redevelopment authorities, and public housing authorities. Because states and political subdivisions are regarded as primarily serving governmental purposes, the Board believes that governmental units generally should not be permitted to maintain NOW accounts. However, under the Board's interpretation, governmental units will be eligible to maintain NOW accounts if the funds are in the name of or are to be used exclusively by schools, libraries, colleges, universities, and hospitals or other educational or medical facilities. The Board believes that funds used for such purposes should be permitted to be placed in NOW accounts in order to accord equal treatment to public entities that perform functions similar to nonprofit entities in the private sector. Thus, if a governmental unit is organized for any one of the listed purposes or maintains an account exclusively for one of those purposes, such funds may be placed in a NOW account. All other governmental accounts will not be eligible for NOW accounts, including redevelopment authorities and public housing authorities. This approach will also eliminate the need for a determination of whether a particular governmental entity is independent or separately constituted as is required under current interpretations.

In order not to disadvantage any current NOW account customers that qualify under existing eligibility criteria but that would no longer be eligible under the Board's interpretation, the Board has determined to grandfather existing NOW accounts that will not qualify under the revised eligibility criteria. All NOW accounts that meet the current

NOW account eligibility criteria may continue in effect if they were established on or before August 31, 1981. After that date, NOW accounts will be limited solely to the new class of eligible depositors.

It should be noted that the Board has not changed the existing policy concerning eligibility for traditional passbook and statement savings accounts.

Effective September 1, 1981, pursuant to its authority under section 19(a) of the Federal Reserve Act (12 U.S.C. § 461(a)), the Board amends Regulation Q (12 CFR Part 217) by adding a new section 217.157 as follows:

§ 217.157 -- Eligibility for NOW and ATS Accounts

(a) Background. (1) Effective December 31, 1980, the Consumer Checking Account Equity Act of 1980 (Title III of the Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. 96-221; 94 Stat. 146) authorizes depository institutions nationwide to offer interest-bearing checking (NOW) accounts to depositors where the "entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit." (12 U.S.C. 1832(a)(2)). The purpose of the Act is to extend the availability of NOW accounts throughout the nation. Previously, as an experiment, NOW accounts were authorized to be offered by depository institutions only in New England, New York, and New Jersey.

(2) The NOW account experiment established by Congress in 1973 did not specify the types of customers that could maintain NOW accounts. As a result, the rules of the Federal Reserve and Federal Deposit Insurance Corporation specified the types of depositors eligible to maintain NOW accounts at member and insured nonmember banks. In enacting the NOW account provision in 1980, Congress adopted virtually the same language concerning NOW account eligibility that previously had been adopted by the Board and the Federal Deposit Insurance Corporation with regard to the types of customers permitted to maintain NOW accounts in institutions located in the NOW account experiment region. (12 CFR 217.1(e)(3) and 12 CFR 329.1(e)(2)). This definition was based upon longstanding regulatory provisions concerning eligibility criteria for savings deposits.

(3) In response to many requests for rulings since the new law was enacted, the Board has determined to clarify the types of entities that may maintain NOW accounts at member banks.

(b) Individuals. (1) Any individual may maintain a NOW account regardless of the purposes that the funds will serve. Deposits of an individual used in his or her business may be held in a NOW account,

since it is impracticable to distinguish between funds used by an individual in his or her business and funds used for personal purposes. However, other entities organized or operated to make a profit may not maintain NOW accounts regardless of whether they are corporations, partnerships, associations, business trusts, or other organizations.

(2) Under current provisions, funds held in a fiduciary capacity (either by an individual fiduciary or by a corporate fiduciary such as a bank trust department), including those awaiting distribution or investment, may be held in the form of NOW accounts if the beneficiaries are individuals. The Board believes that such a classification should continue since fiduciaries are required to invest even temporarily idle balances to the greatest extent feasible in order to responsibly carry out their fiduciary duties. The availability of NOW accounts provides a convenient vehicle for providing a short-term return on temporarily idle trust funds of individuals.

(3) Pension funds, escrow accounts, security deposits, and other funds held under various agency agreements may also be classified as NOW accounts if the entire beneficial interest is held by individuals. The Board believes that these accounts are similar in nature to trust accounts and should be accorded identical treatment. Therefore, such funds may be regarded as eligible for classification as NOW accounts.

(c) Nonprofit Organizations. (1) Under the Act, a nonprofit organization that is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes may maintain a NOW account. The Board regards the following kinds of organizations as eligible for NOW accounts under this standard if they are not operated for profit:

(i) organizations described in section 501(c)(3) through (13), and (19) of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) § 501(c)(3) through (13) and (19); and

(ii) homeowners and condominium owners associations described in section 528 of the Internal Revenue Code (26 U.S.C. (I.R.C. 1954) § 528), including housing cooperative associations that perform similar functions.

(2) All organizations that are operated for profit are not eligible to maintain NOW accounts at member banks.

(3) The following types of organizations described in the cited provisions of the Internal Revenue Code are among those not eligible to maintain NOW accounts:

(i) credit unions and other mutual depository institutions described in § 501(c)(14);

- (ii) mutual insurance companies described in § 501(c)(15);
- (iii) crop financing organizations described in § 501(c)(16);
- (iv) an organization created to function as part of a qualified group legal services plan described in § 501(c)(20);
- (v) farmers' cooperatives described in § 521; or
- (vi) political organizations described in § 527.

(d) Governmental Units. Under the Act, governmental units generally may not maintain NOW accounts. The Board believes that some governmental units are operated primarily for philanthropic, educational, or charitable purposes, and that such entities should be regarded as eligible to maintain NOW accounts. Consequently, a governmental unit, regardless of form of organization, may maintain a NOW account if the funds are in the name of or are used solely for schools, universities or colleges, libraries, hospitals, or other educational or medical facilities.

(e) Grandfather Provision. In order to avoid unduly disrupting account relationships, a NOW account established at a member bank on or before August 31, 1981, that represents funds of a nonqualifying entity that previously qualified to maintain a NOW account may continue to be maintained.

By order of the Board of Governors, August 13, 1981.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

[SEAL]

TITLE 26—INTERNAL REVENUE CODE

§ 501. Exemption from tax on corporations, certain trusts, etc.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(5) Labor, agricultural, or horticultural organizations.

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players) not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(7) Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

(8) Fraternal beneficiary societies, orders, or associations—

(A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

(9) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

(10) Domestic fraternal societies, orders, or associations, operating under the lodge system—

(A) the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and

(B) which do not provide for the payment of life, sick, accident, or other benefits.

(11) Teachers' retirement fund associations of a purely local character, if—

(A) no part of their net earnings inures

(other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and

(B) the income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

(12) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

(13) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremation which is not permitted by its charter to engage in any business not necessarily incident to that purpose and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(19) A post or organization of war veterans, or an auxiliary unit or society of, or a trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions,

(B) at least 75 percent of the members of which are war veterans and substantially all of the other members of which are individuals who are veterans (but not war veterans), or are cadets, or are spouses, widows, or widowers of war veterans or such individuals, and

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

§ 528. Certain homeowners associations

(a) General rule

A homeowners association (as defined in subsection (c)) shall be subject to taxation under this subtitle only to the extent provided in this section. A homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

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