DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

23 CFR Part 630

[FHWA Docket No. FHWA–2005–20764]

RIN 2125–AF05

Project Authorization and Agreements

AGENCY: Federal Highway Administration (FHWA), DOT.

ACTION: Final rule.

SUMMARY: The FHWA is revising its regulations relating to project authorization and agreements and the effect on obligations of Federal-aid highway funds under these requirements. The changes in this rulemaking will assist the States and the FHWA in monitoring Federal-aid highway projects and provide greater assurance that the Federal funds obligated reflect the current estimated cost of the project. In the event that Federal funds are de-obligated as a result of these changes, those funds may then be obligated for new or other active projects needing additional funding to the extent permitted by law.

EFFECTIVE DATE: March 2, 2006.

FOR FURTHER INFORMATION CONTACT: Mr. Dale Gray, Federal-aid Financial Management Division, (202) 366–0978, or Mr. Steven Rochlis, Office of the Chief Counsel, (202) 366–1395, Federal Highway Administration, 400 Seventh Street SW., Washington, DC 20590. Office hours are from 7:45 a.m. to 4:15 p.m., e.t., Monday through Friday, except Federal holidays.

SUPPLEMENTARY INFORMATION:

Electronic Access

An electronic copy of this document may be downloaded by using the Internet to reach the Office of the Federal Register's home page at: *http://www.archives.gov* and the Government Printing Office's Web page at: *http://www.access.gpo.gov/nara*.

Background

The FHWA currently funds more than 120,000 highway projects that are administered by State and local governments. The amount of Federal funds legally obligated (committed) to a project is generally based on an estimate of the cost to complete the project. As a project progresses, those costs may increase or decrease. The U.S. Department of Transportation's Office of Inspector General has repeatedly found that some States have failed to timely release Federal funds when project estimates decrease or when projects are completed and no additional expenditures are expected.[1] The failure to take timely action reduces the amount of Federal funds available to finance new projects. The FHWA has worked with the States for many years to identify projects where funds can be released and has recommended that States adopt certain best practices to further the efficient use of Federal funds. Nevertheless, in Fiscal Year 2005, the FHWA identified over $750 million of Federal funds on inactive projects that could be released, and in most cases reapplied to new projects. Because substantial unneeded obligations continue to be identified, despite the implementation of best practice procedures in many States, the FHWA believes regulations are necessary to clearly define the responsibilities and procedures for identifying and releasing these funds. In addition, as a Federal agency, the FHWA is responsible for maintaining valid obligations and must annually certify that the amounts shown as obligated in its financial statements are accurate.

The FHWA is revising its regulation relating to project agreements, 23 CFR 630, to establish a systematic process that will assist the States and FHWA in monitoring projects, provide greater assurance that the amount of Federal funds obligated on a project reflects the current cost estimate, and ensure that funds no longer needed are de-obligated in a timely manner. The new requirements included in the final rule are consistent with Federal appropriation law principles requiring Federal obligations to be based on a documented cost estimate and revised if the estimate changes.[2]

The regulation will require the States to monitor projects and (1) de-obligate Federal funds when the amount obligated exceeds the current cost estimate by $250,000 or more, and (2) re-evaluate cost estimates on inactive projects and release unneeded funds. The FHWA will revise the Federal obligation amount if the State fails to take action as required by the regulation.

Notice of Proposed Rulemaking (NPRM)

The FHWA published a notice of proposed rulemaking (NPRM) on July 11, 2005, at 70 FR 39692. In the NPRM, the FHWA proposed to (1) require the de-obligation of Federal funds that remain committed to inactive projects as well as require the de-obligation of excess funds not needed for a project; (2) reduce the occurrences where Federal funds are committed to inactive projects or where an obligation is in excess of the amount needed to complete the project; (3) establish a project completion date that would be added in all new project agreements and in those cases where modifications are made to existing project agreements; and (4) require States to assure that third party contracts and agreements are processed and billed promptly when the work is completed.

We received comments from 56 entities. The comments that were received included; 37 State transportation departments (States), 10 local governments, four metropolitan planning organizations, two companies, one individual representing five States, and two national associations, the American Association of State Highway and Transportation Officials (AASHTO) and the Association of American Railroads (AAR).

Discussion of Comments by Section

General

Thirty commenters included a statement supporting the efficient use of Federal funds and closing out projects. For example, AASHTO, which represents the State transportation departments, expressed full support for the goal of increasing the efficient use of Federal funds and the timeliness of project close-outs, but expressed substantial concern that the proposed provisions would be burdensome for the State and local governments to implement. Comments from the TG Associates expressed support for FHWA's commitment and efforts to foster fiscal stewardship and improve financial management. Michigan DOT agreed that adequate financial controls need to be in place to make certain that all available Federal funds are used in a timely fashion for transportation improvements, but was concerned about the ''one-size-fits-all approach'' proposed in the NPRM. The County of Los Angeles, California, agreed with the overall objective of the proposed changes and stated that an increase in the collaborative efforts among the FHWA, the States, and third-party agencies is needed to improve the management of Federal funds.

Twenty-seven commenters expressed opposition to some or all of the proposed changes. Among the reasons

[1] See DOT IG Report Number FI–2006–011, entitled, ''Inactive Obligations, Federal Highway Administration,'' dated November 14, 2005, available at *http://www.oig.dot.gov/item.jsp?id=1722*.

[2] See the ''Principles of Federal Appropriations Law, 3rd Edition'' available at *http://www.gao.gov/special.pubs/redbook1.html*.

given for those in opposition were that the unilateral action on the part of FHWA to de-obligate funds is contrary to the cooperative working relationship of the States and the FHWA, concern that a State may lose funds, concern that the process would be burdensome for the States, and States that currently manage funds effectively would be penalized under a one-size-fits-all approach. AASHTO recommended that the FHWA work cooperatively with the States to develop a rule that works for all parties.

The FHWA has been working with the States for a number of years, but these efforts have not resulted in a reduced level of unneeded obligations on a national level. In our view, a consistent policy is necessary for the States to clearly understand the level of effort necessary to properly manage Federal funds. While some commenters were concerned that the requirements would be burdensome, we believe that the effective management of funds is a prudent government agency business practice. The FHWA recognizes that some States may need to apply additional resources to manage funds to meet the requirements of this rule, but the result is that funds will be made available to finance new or active projects that will benefit the State in meeting its transportation needs. The regulation does not require the release of any funds that are needed for a valid and current obligation.

There were some questions about the application of these new requirements, i.e., would the requirements apply to all projects, and how are projects defined? For example, the Arizona DOT recommended that congressionally mandated projects be exempt from the proposed changes, and the South Carolina DOT recommended that a State be allowed to choose whether to define a project as the entire project or as a phase of the project. The Tri-County Regional Planning Commission, California, recommended that projects for statewide planning and environmental studies be excluded from the proposed requirements.

The requirements established in the final rule apply to any project for which the State and the FHWA enter into a project agreement under Title 23 CFR 630, subpart A, which generally includes congressionally mandated projects and planning projects. There is no basis to exempt any project from the requirement to maintain a valid obligation. The scope of the project is defined in the project agreement that is initiated by the State and may include only a single phase of work, such as design or construction, or may include multiple phases under a single agreement.

Section 630.106

In the NPRM, we proposed to include section 630.106(a)(3) that would have required the States to promptly (1) revise the amount obligated on a project when the cost estimate decreases by $100,000 or 10 percent and (2) to adjust the amount obligated on inactive projects that are expected to be inactive for 24 months.

Most of the commenters stated that modifying changes of ''$100,000 or 10 percent'' would require additional administrative effort by the State and local agencies and would result in an inefficient use of limited resources. Since project costs range from a few thousand dollars to tens of millions of dollars, many of the commenters recommended that different parameters be established. Recommended parameters ranged from $200,000 to $500,000 and from 2 percent to 10 percent of project costs. For example, the Indiana Department of Transportation (DOT) stated that a more workable solution would be to change the threshold to $250,000. The Connecticut DOT and Maryland DOT recommended parameters of $250,000 or 5 percent, whichever is greater, and the Florida DOT recommended that projects with estimated costs of $5,000,000 or less be exempt from the requirement.

We agree that the parameters should be changed to enable the States to focus resources on significant sums of Federal funds obligated on large-scale projects. Based upon the comments such as those mentioned above, the FHWA is revising this provision to require a State to maintain a process for revising cost estimates as required by Federal appropriations law principles referenced in the Background section. As a minimum, a State will be required to revise the Federal obligation amount on a project within 90 days when the Federal share decreases by $250,000 or more.

Most of the commenters recommended that the term ''promptly'' be removed from the regulation or be specifically defined. The Pennsylvania DOT stated that the term ''promptly'' could be interpreted to require daily accounting and adjustment of Federal-aid obligations. While the commenters did not suggest a definition for the term, we agree that the term should be defined and have defined ''promptly'' as being ''within 90 days after the State or local agency determines that the costs have decreased.'' We believe that 90 days after the determination that an adjustment to the obligation amount is needed is sufficient time to process a modified agreement to adjust the obligations.

The Michigan DOT stated that financial monitoring should occur at the end of each phase of a job/project. We agree that this should not be a daily activity and are including language to clarify that re-estimates would only be expected at the end of a project phase or when some other significant event occurred that would impact project costs, such as a value engineering study or a change in design. For clarity we have separated this provision that relates to all projects from the provision that relates to ''inactive projects.''

Some commenters expressed concern about the use of the term, ''inactive projects.'' The term was defined in the NPRM as projects for which no costs have been billed to FHWA in the past 12 months. We recognize that a number of factors can result in no billings for 12 months, but the objective of the requirement is to identify projects that need to be evaluated and a lack of billing is the best indicator available to the FHWA that a project may be stalled or completed. If the State determines that work on the project is still underway or that the obligation amount is valid, then no further action is needed. Most commenters recommended that the inactivity threshold be extended to 24 months. For example, AASHTO stated that 24 months of inactivity on a project is a more reasonable timeframe than 12 months because there are multiple reasons why projects may not be finalized within a one-year period.

We agree that 24 months may be an appropriate time period for most projects and have revised the rule to state that projects with unexpended obligations of $50,000 to $500,000 are not required to be evaluated until they are determined to be inactive for a 24-month period. However, we believe that 12 months is a more appropriate time to review the projects that have larger amounts of unexpended obligations so that if unneeded funds are identified, these more significant amounts do not remain idle for an additional year. Our current practice is to review projects that are inactive for 12 months with unexpended obligations over $500,000. As noted in the background section, our review in Fiscal Year 2005 identified over $750 million that could be applied to active projects. We believe that these projects should be reviewed after 12 months of inactivity. Allowing the States to review projects with $50,000 to $500,000 of unexpended obligations after two years of inactivity will reduce

the burden on the States in complying with this provision. To further reduce the State's burden, the final rule allows projects with unexpended obligations less than $50,000 to be reviewed after 36 months of inactivity.

Recognizing that projects may be entering inactive status on a daily basis, the FHWA is clarifying that States are not required to review inactive projects more often than quarterly. Previously, the FHWA reviewed inactive projects on an annual basis but has determined that an annual review allows unneeded funds to remain on a project too long before a review is performed. Quarterly reviews also result in a more orderly and routine review and analysis of inactive projects.

Some commenters were concerned about the provision that would have required adjustments to projects that are ''unlikely to proceed within the next 12 months,'' stating that such a determination would be difficult to predict in most cases. For example, Montana DOT stated that additional clarification is needed to define what is meant by ''unlikely to proceed.'' The purpose of this provision was to ensure that funds are not obligated for a project prematurely which would tie-up funds that should be used for projects that are ready to be advanced. We agree with the comments that it would be difficult to determine that a project is ''unlikely to proceed'' and are not including the provision in the final rule. We are replacing this provision with a general provision that an obligation of Federal funds must be documented and based on the State's best estimate of costs. This provision reflects the requirements of the Federal appropriations law principles as discussed in the background section.

In the NPRM, we proposed to revise obligations when the State fails to take the required actions under these requirements. Some commenters suggested that the FHWA should have the discretion to take action, but that it should not be a mandatory requirement so that the FHWA can adequately react to the various circumstances. Since this rule requires the States to take specific actions to manage funds, we believe that if the FHWA has determined that a de-obligation of funds is appropriate and the State has failed to act in a timely manner, that the FHWA should revise the obligations or take other appropriate action.

Most commenters recommended that the FHWA should be required to consult with the State before adjusting obligations. The Arizona DOT strongly objected to the language in the NPRM because it allows the FHWA to de-obligate Federal funds on a project with absolutely no consultation with the State. The Arizona DOT recommended that the State be notified 60 days before funds are de-obligated. We agree that the FHWA should advise and consult with the State before the FHWA unilaterally de-obligates funds. We have added a statement in the rule that the FHWA will advise the State of its proposed actions and provide an opportunity for the State to respond. We did not specify an amount of time to be provided to the State to respond as recommended by Arizona DOT because circumstances will differ from State to State. We view this action on the part of the FHWA as a remedy of last resort, and expect unilateral actions by FHWA to be rare.

Concerns were expressed that de-obligations at the end of the fiscal year may result is a loss of obligation authority. For example, the California DOT stated that FHWA should make sure that the States do not lose any obligation authority if the timing of de-obligations is close to the end of the Federal fiscal year. We also recognize that Congress intends that all obligation authority be used before the end of a fiscal year, and to further such intent Congress provides for an August redistribution of that authority to ensure that it is fully used. The final rule has been revised to include a provision that no adjustments in obligations will occur from August 1 to September 30 to ensure the efficient execution of the August redistribution process unless the State requests the adjustment.

Sections 630.108 and 630.110

In the NPRM, the FHWA proposed revisions to sections 630.108 and 630.110 that would have required States to establish a project completion date in the Federal-aid project agreement. If the project is delayed, the completion date could be revised except that the date could not be changed because of a delay in billing or processing third party claims. When the completion date occurs, the State would be required to close the project within 90 days.

Almost all commenters expressed opposition to these provisions. AASHTO summed up many of the comments by stating that the definition of ''project completion date'' needs to be clarified; it is impractical to establish project completion dates in the early phases of project development; it is impossible for the States to ensure third party compliance, particularly those States that have statutory time allowances for submitting claims; and that the 90-day closing requirement would result in State and local agencies having to absorb the remaining costs without reimbursement. The AAR stated that the project completion date provides insufficient time for the processing of bills and that closure and release of unexpended funds within 90 days of the completion date is inconsistent with commercial practices.

In response to these comments, we will not revise sections 630.108 and 630.110 at this time. The FHWA plans to modify its Fiscal Management Information System (FMIS) during Fiscal Year 2006 to include a project completion date simply as an information item. The FMIS tracks the amount of and type of Federal funds obligated on individual Federal-aid highway projects and collects a variety of data on the projects, such as, type of work, location, project description, etc. We will work with the States to better define the project completion date and the best way to use the date to improve project funds management.

Rulemaking Analyses and Notices

Executive Order 12866 (Regulatory Planning and Review) and DOT Regulatory Policies and Procedures

The FHWA has determined that this final rule is not a significant regulatory action within the meaning of Executive Order 12866 or significant within the meaning of Department of Transportation regulatory policies and procedures. We anticipate that the economic impact of this rulemaking will be minimal. In fact, funds released as a result of a de-obligation under this rule will be credited to the same program category and will be immediately available for obligation and expenditure on eligible projects in accordance with 23 U.S.C. 118(d). This final rule will not adversely affect, in a material way, any sector of the economy. In addition, these changes will not interfere with any action taken or planned by another agency and will not materially alter the budgetary impact of any entitlements, grants, user fees, or loan programs.

Regulatory Flexibility Act

In compliance with the Regulatory Flexibility Act (Pub. L. 96–354, 5 U.S.C. 601–612) the FHWA has evaluated the effects of this final rule on small entities and has determined that the action will not have a significant economic impact on a substantial number of small entities. This final rule addresses obligations of Federal funds to States for Federal-aid highway projects. As such, it affects only States and States are not included in the definition of small entity set forth in 5 U.S.C. 601. Therefore, the Regulatory Flexibility Act

does not apply and the FHWA certifies that this action will not have a significant economic impact on a substantial number of small entities.

Unfunded Mandates Reform Act of 1995

This final rule does not impose unfunded mandates as defined by the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4, March 22, 1995, 109 Stat. 48). This rule will not result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. Additionally, the definition of ''Federal Mandate'' in the Unfunded Mandates Act excludes financial assistance of the type in which State, local, or tribal governments have authority to adjust their participation in the program in accordance with changes made in the program by the Federal government. The Federal-aid highway program permits this type of flexibility.

Executive Order 13132 (Federalism)

This final rule has been analyzed in accordance with the principles and criteria contained in Executive Order 13132, and the FHWA has determined that this action does not have sufficient federalism implications to warrant the preparation of a federalism assessment. The FHWA has also determined that this action does not preempt any State law or State regulation or affect the States' ability to discharge traditional State governmental functions.

Executive Order 12372 (Intergovernmental Review)

Catalog of Federal Domestic Assistance Program Number 20.205, Highway Planning and Construction. The regulations implementing Executive Order 12372 regarding intergovernmental consultation on Federal programs and activities apply to this program.

Paperwork Reduction Act

This action does not contain a collection of information requirement under the Paperwork Reduction Act of 1995, 44 U.S.C. 3501–3520.

National Environmental Policy Act

The FHWA has analyzed this final rule for the purpose of the National Environmental Policy Act of 1969 (42 U.S.C. 4321–4347) and has determined that this action will not have any effect on the quality of the environment.

Executive Order 12630 (Taking of Private Property)

This action will not affect the taking of private property or otherwise have taking implications under Executive Order 12630, Government Actions and Interface with Constitutionally Protected Property Rights.

Executive Order 12988 (Civil Justice Reform)

This action meets applicable standards in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

Executive Order 13045 (Protection of Children)

We have analyzed this final rule under Executive Order 13045, Protection of Children from Environmental Health Risks and Safety Risks. The FHWA certifies that this action will not cause an environmental risk to health or safety that might disproportionately affect children.

Executive Order 13175 (Tribal Consultation)

The FHWA has analyzed this final rule under Executive Order 13175, dated November 6, 2000, and believes that this action will not have substantial direct effects on one or more Indian tribes; will not impose substantial direct compliance costs on Indian tribal governments; and will not preempt tribal laws. This final action addresses obligations of Federal funds to States for Federal-aid highway projects and will not impose any direct compliance requirements on Indian tribal governments. Therefore, a tribal summary impact statement is not required.

Executive Order 13211 (Energy Effects)

We have analyzed this action under Executive Order 13211, Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use Dated May 18, 2001. We have determined that it is not a significant energy action under that order because it is not a significant regulatory action under Executive Order 12866 and it is not likely to have a significant adverse effect on the supply, distribution, or use of energy. Therefore, a Statement of Energy Effects is not required.

Regulation Identification Number

A regulation identification number (RIN) is assigned to each regulatory action listed in the Unified Agenda of Federal Regulations. The Regulatory Information Service Center publishes the Unified Agenda in April and October of each year. The RIN contained in the heading of this document can be used to cross-reference this action with the Unified Agenda.

List of Subjects in 23 CFR Part 630

Reimbursement, Grant programs—transportation, Highways and roads.

Issued on: January 25, 2006.

J. Richard Capka,

Acting Federal Highway Administrator.

■ In consideration of the foregoing, the FHWA is amending title 23, part 630, Code of Federal Regulations as follows:

PART 630—PRECONSTRUCTION PROCEDURES

Subpart A—Project Authorization and Agreements

■ 1. The authority citation for part 630 continues to read as follows:

Authority: 23 U.S.C. 106, 109, 115, 315, 320, and 402(a); 31 U.S.C. 1.32; and 49 CFR 1.48(b).

■ 2. Amend § 630.106 by revising the heading to read as set forth below, and adding paragraphs (a)(3), (4), (5), and (6) to read as follows:

§ 630.106 Authorization to proceed and Project Monitoring.

(a) * * *

(3) The State's request that Federal funds be obligated shall be supported by a documented cost estimate that is based on the State's best estimate of costs.

(4) The State shall maintain a process to adjust project cost estimates. For example, the process would require a review of the project cost estimate when the bid is approved, a project phase is completed, a design change is approved, etc. Specifically, the State shall revise the Federal funds obligated within 90 days after it has determined that the estimated Federal share of project costs has decreased by $250,000 or more.

(5) The State shall review, on a quarterly basis, inactive projects (for the purposes of this subpart an ''inactive project'' means a project for which no expenditures have been charged against Federal funds for the past 12 months) with unexpended Federal obligations and shall revise the Federal funds obligated for a project within 90 days to reflect the current cost estimate, based on the following criteria:

(i) Projects inactive for the past 12 months with unexpended balances more than $500,000,

(ii) Projects inactive for the past 24 months with unexpended balances of $50,000 to $500,000, and

(iii) Projects inactive for the past 36 months with unexpended balances less than $50,000.

(6) If the State fails to comply with the requirements of paragraphs (a)(3), (4), or (5) of this section, then the FHWA shall revise the obligations or take such other action as authorized by 23 CFR 1.36. The FHWA shall advise the State of its proposed actions and provide the State with the opportunity to respond before actions are taken. The FHWA shall not adjust obligations without a State's consent during the August redistribution process, August 1 to September 30.

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[FR Doc. 06–863 Filed 1–30–06; 8:45 am]

BILLING CODE 4910–22–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9248]

RIN 1545–BC86

Residence Rules Involving U.S. Possessions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations, temporary regulations, and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide rules for determining bona fide residency in the following U.S. possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the United States Virgin Islands under sections 937(a) and 881(b) of the Internal Revenue Code (Code).

DATES: *Effective Date:* These regulations are effective January 31, 2006.

Applicability Dates: For dates of applicability, see §§ 1.881–5(f)(8) and 1.937–1(i).

FOR FURTHER INFORMATION CONTACT: J. David Varley, (202) 435–5262 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1930.

The collections of information in these final regulations are in § 1.937–1. The collection of information required by § 1.937–1(h) is to ensure that individuals claiming to become, or cease to be, residents of a U.S. possession file notice of such a claim with the Internal Revenue Service in accordance with section 937(c) of the Code. Individuals subject to this reporting requirement must retain information to establish their residency as required by section 937(c) of the Code and § 1.937–1. An additional collection of information in these final regulations is in § 1.937–1(c)(4)(iii). This information is required to satisfy the documentation and production requirements for individuals who come within an exception to the presence test of § 1.937–1(c) as a consequence of receiving (or accompanying certain family members who receive) qualifying medical treatment.

The collections of information are mandatory and will be used for audit and examination purposes. The likely respondents are individuals who become (or cease to be) bona fide residents of a U.S. possession and individuals who, in satisfying the presence test requirement for bona fide residence in a possession, exclude days in the U.S. or include days in a relevant possession because they receive (or accompany certain family members who receive) qualifying medical treatment.

Estimated total annual reporting and/or recordkeeping burden: 300,000 hours.

Estimated average annual burden hours per respondent: 4 hours.

Estimated number of respondents: 75,000.

Estimated annual frequency of responses: annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

The American Jobs Creation Act of 2004 (Pub. L. 108–357) was enacted on October 22, 2004. Section 809 of the Act added section 937 to the Code, relating to residence, source, and effectively connected income with respect to the U.S. possessions. On April 11, 2005, the IRS and Treasury published in the **Federal Register** temporary regulations (TD 9194, 70 FR 18920, as corrected at 70 FR 32589–01), which provided rules to implement section 937 and to conform existing regulations to other legislative changes with respect to U.S. possessions. A notice of proposed rulemaking (REG–159243–03, 70 FR 18949) cross-referencing the temporary regulations was published in the **Federal Register** on the same day. Written comments were received in response to the notice of proposed rulemaking and a public hearing on the proposed regulations was held on July 21, 2005. The proposed regulations relating to the residence rules (specifically, §§ 1.937–1 and 1.881–5T(f)(4)) are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The revisions are discussed below. The remainder of the proposed and temporary regulations, relating to source and effectively connected income with respect to U.S. possessions, will be finalized together with the other conforming changes in a forthcoming Treasury decision.

Explanation of Provisions and Summary of Comments

The proposed and temporary regulations under Code section 937(a) provide rules for determining whether an individual is a ''bona fide resident'' of a U.S. possession. Generally, § 1.937–1T provides that an individual is a bona fide resident of a possession if the individual meets a presence test, a tax home test and a closer connection test. The IRS received comments relating to each of the three tests.

I. Presence Test

A. General Rule

Under section 937(a)(1), in order to satisfy the presence test, a person must be present in the possession for at least 183 days during the taxable year (the 183-day rule). The proposed and temporary regulations provide several alternatives to the 183-day rule for purposes of satisfying the presence test. Thus, an individual who does not satisfy the 183-day rule nevertheless meets the presence test under the proposed and temporary regulations if the individual spends no more than 90