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December 09, 2004

Legend

Issuer =

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Dear :

This is in response to the request submitted on behalf of the Issuer for a ruling that:

(1) the average reasonably expected economic life within the meaning of § 147(b) of the Internal Revenue Code of 1986 (the "1986 Code") of the Computer Software (as defined below) is determined based on all of the Issuer's particular facts and circumstances; and

(2) the statutory three-year "useful life" of computer software for depreciation purposes under § 167(f)(1) and the administrative guidelines for the treatment of computer software costs under Rev. Proc. 2000-50, 2000-1 C.B. 601, will not bar the Issuer from establishing a longer average reasonably expected economic life of the Computer Software for purposes of § 147(b).

Facts and representations

The Issuer intends to issue bonds in a maximum principal amount not to exceed \$a (the "Bonds") to finance all or a portion of the costs of certain computer software which it will use to perform administrative functions, including financial accounting, procurement, payroll, and personnel administration (the "Computer Software"). The Issuer does not request a ruling as to the average reasonably expected economic life of the Computer Software. The Issuer requests this ruling to help the Issuer determine whether the

Bonds will meet the safe harbor against the creation of replacement proceeds under § 1.148-1(c)(4)(i)(B)(2) of the Income Tax Regulations and whether the Bonds will have an average maturity that is no longer than reasonably necessary for the governmental purposes of the Bonds.

Law and analysis

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b) provides in part that § 103(a) shall not apply to any arbitrage bond (within the meaning of § 148).

Section 148(a) provides that, for purposes of § 103, the term “arbitrage bond” means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly (1) to acquire higher yielding investments, or (2) to replace funds which were used directly or indirectly to acquire higher yielding investments. Section 148(a) further provides that, for purposes of § 148, a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part directly or indirectly to acquire, or replace funds which were used to acquire, higher yielding investments.

Section 1.148-2(a) provides, in part, that under § 148(a), the direct or indirect investment of gross proceeds of an issue in higher yielding investments causes the bonds of the issue to be arbitrage bonds. Section 1.148-1(b) defines “gross proceeds” to mean any proceeds and replacement proceeds of an issue.

Section 1.148-1(c)(4)(i)(A) provides that replacement proceeds arise to the extent that the issuer reasonably expects as of the issue date that (1) the term of an issue will be longer than is reasonably necessary for the governmental purposes of the issue, and (2) there will be available amounts during the period that the issue remains outstanding longer than necessary. Section 1.148-1(c)(4)(i)(B) provides a safe harbor against creation of replacement proceeds. Specifically, § 1.148-1(c)(4)(i)(B)(2) provides that replacement proceeds do not arise under § 1.148-1(c)(4)(i)(A) for the portion of an issue (including a refunding issue) that is to be used to finance or refinance capital projects, if that portion has a weighted average maturity that does not exceed 120 percent of the average reasonably expected economic life of the financed capital projects, determined in the same manner as under § 147(b).

Section 1.148-10(a)(1) generally provides that bonds of an issue are arbitrage bonds under § 148 if an abusive arbitrage device under § 1.148-10(a)(2) is used in connection with the issue. Section 1.148-10(a)(2) provides that any action is an abusive arbitrage device if the action has the effect of (i) enabling the issuer to exploit the difference between the tax-exempt rate and taxable interest rates to obtain a material financial advantage; and (ii) overburdening the tax-exempt bond market. Section 1.148-10(a)(4) provides that an action overburdens the tax-exempt bond market under § 1.148-

10(a)(2)(ii) if the action results in issuing more bonds, issuing bonds earlier, or allowing bonds to remain outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes of the bonds, based on all the facts and circumstances. One factor evidencing that the bonds may remain outstanding longer than necessary is a term that exceeds the safe harbors against the creation of replacement proceeds under § 1.148-1(c)(4)(i)(B).

Section 147(b)(1) provides that, except as otherwise provided in § 147(h), a private activity bond shall not be a qualified bond if it is issued as part of an issue and (A) the average maturity of the bonds issued as part of such issue exceeds (B) 120 percent of the average reasonably expected economic life of the facilities being financed with the net proceeds of such issue.

Section 147(b) does not define “economic life.” Section 147(b) has its origins in § 103(b)(14) of the Internal Revenue Code of 1954 (the “1954 Code”).¹ Section 103(b)(14) was added to the 1954 Code by the Tax Equity and Fiscal Responsibility Act of 1982, § 219, 1982-2 C.B. 462, 496. The Conference Report on H.R. 4961, H. R. Conf. Rep. No. 97-760, at 519-20 (1982), 1982-2 C.B. 624-25 (the “1982 Conference Report”), states:

In general, the economic life of assets is to be determined on a case-by-case basis. However, in order to provide guidance and certainty, the conferees intend that the administrative guidelines established for the useful lives used for depreciation prior to the ACRS System (*i.e.*, the midpoint lives under the ADR System where applicable and the guideline lives under Rev. Proc. 62-21, 1962-2 C.B. 418, in the case of structures) may be used to establish the economic lives of assets. However, the taxpayer can issue bonds with maturities longer than these administrative guidelines would allow where the taxpayer can show, on the basis of the facts and circumstances, that the economic life to the principal user or users of the assets for whom the bonds are issued is longer than the lives established by the administrative guidelines.

This legislative history clearly indicates that generally the determination of the economic life of bond-financed property is to be made on a case-by-case basis. However, it also indicates that issuers may, but are not required to, use the administrative guidelines for

¹ The Tax Reform Act of 1986, § 1301, 1986-3 (Vol. 1) C.B. 1, 519 (the “1986 Act”), reorganized §§ 103 and 103A of the 1954 Code into §§ 103 and 141 through 150 of the 1986 Code. The legislative history to the 1986 Act states that, to the extent not amended by the 1986 Act, all principles of law prior to the 1986 Act would continue to apply to the reorganized provisions. H.R. Conf. Rep. 99-841, at II-686 (1986), 1986-3 (Vol. 4) C.B. 686.

the useful lives used for depreciation prior to the ACRS system to establish the economic lives of bond-financed assets.

In referring to these administrative guidelines for depreciation, the 1982 Conference Report specifies the midpoint lives under the ADR (Asset Depreciation Range) system where applicable, and the guideline lives under Rev. Proc. 62-21, in the case of structures. However, computer software was not subject to the ADR system. Nevertheless, the administrative guideline for the useful life of computer software was set forth in Rev. Proc. 69-21, 1969-2 C.B. 303, as 5 years. In 1993, § 167(f)(1), providing a 36-month useful life of computer software for depreciation purposes, was added to the 1986 Code by the Omnibus Budget Reconciliation Act of 1993, § 13261(b)(1), 1993-3 C.B. 1, 126. Rev. Proc. 2000-50 supersedes Rev. Proc. 69-21, conforming the useful life of computer software under the administrative guideline to that under § 167(f)(1).

The legislative history of 147(b) expressly states that an issuer can issue bonds with maturities longer than the administrative guidelines for depreciation would allow where the issuer can show, on the basis of the facts and circumstances, that the economic life to the principal user or users of the assets for whom the bonds are issued is longer than the lives established by the administrative guidelines.

Conclusion

Accordingly, we conclude that (1) § 147(b) allows the Issuer to establish the average reasonably expected economic life of the Computer Software based on its particular facts and circumstances; and (2) the three-year useful life provided under § 167(f)(1) or Rev. Proc. 2000-50 for depreciation purposes does not bar the Issuer from establishing a longer average reasonably expected economic life of the Computer Software for purposes of § 147(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express no opinion as to the average reasonably expected economic life of the Computer Software within the meaning of § 147(b).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the 1986 Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)

By: _____
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