

Section 141.—Private Activity Bond; Qualified Bond

T.D. 8712

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

Definition of Private Activity Bonds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations on the definition of private activity bonds applicable to tax-exempt bonds issued by state and local governments. These final regulations reflect changes to the applicable law that were made by the Technical and Miscellaneous Revenue Act of 1988. These regulations affect issuers of tax-exempt bonds and provide needed guidance for applying the private activity bond restrictions.

DATES: These regulations are effective May 16, 1997.

For dates of applicability of these regulations, see §§ 1.141–15, 1.141–16, 1.148–6(a)(3) and 1.148–6(d)(1)(iii) of these regulations.

FOR FURTHER INFORMATION CONTACT: Loretta J. Finger or Nancy M. Lashnits, (202) 622–3980 (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 (44 U.S.C. 3507) under control number 1545–1451. Responses to these collections of information are mandatory. Pursuant to comments received, the collections of information have been amended, but the estimated annual burden per respondent/recordkeeper has not changed.

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

The estimated average annual burden hours per respondent/recordkeeper: 3 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20024, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to collections of information must be retained as long as their contents may 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

Removal of existing regulations for repealed sections

Prior to the enactment of the Tax Reduction and Simplification Act of 1977 (Pub. L. 95–30), sections 141 through 144 contained provisions of the Internal Revenue Code of 1954 relating to the standard deduction. Sections 141 (“Standard Deduction”), 142 (“Individuals Not Eligible for Standard Deduction”), and 144 (“Election of Standard Deduction”) were repealed by section 101(d)(1) of that act. Section 143 (“Determination of Marital Status”) was redesignated section 7703 by section 1301(j)(2) of the Tax Reform Act of 1986 (Pub. L. 99–514). Therefore, existing regulations §§ 1.141–1, 1.142–1, 1.142–2, 1.144–1, 1.144–2, and 1.144–3 are being removed from the Code of Federal Regulations (CFR), and regulation § 1.143–1 is being redesignated § 1.7703–1.

Proposed Regulations

On December 30, 1994, proposed regulations (FI–72–88 [1995–1 C.B. 859]) were published in the **Federal Register** (59 FR 67658) to provide guidance under the Internal Revenue Code of 1986 (Code) in sections 141 (relating to private activity bonds and to qualified bonds), 142 (relating to exempt-facility bonds), 145 (relating to qualified 501(c)(3) bonds), 147 (relating to other requirements applicable to certain private activity bonds), 148 (relating to arbitrage), 150 (relating to change of use), and 1394 (relating to enterprise zone facility bonds). All subsequent references in this preamble to Code sec-

tions are to the Internal Revenue Code of 1986. On June 8, 1995, the IRS held a public hearing on the proposed regulations. Written comments responding to the proposed regulations were received.

On May 31, 1996, final regulations (FI–72–88) were published in the **Federal Register** (61 FR 106) to provide guidance under Code section 1394 to address the issues relating to enterprise zone facility bonds. After consideration of all the comments, certain of the proposed regulations under Code sections 141, 142, 144, 145, 147, 148, and 150 are adopted as revised by this Treasury decision. The principal revisions to the proposed regulations are discussed below.

Explanation of Provisions

Certain commentators suggested that the proposed regulations, with certain modifications, be published again as proposed regulations. A number of other commentators suggested that the proposed regulations, with certain modifications, should be promulgated as final regulations to provide certainty at the earliest possible time. After considering these comments, the IRS and Treasury concluded that state and local government issuers would benefit from the adoption of the proposed regulations, with certain modifications made in response to comments, as final regulations.

A. Section 1.141–1 Definitions and rules of general application

Replaced amounts. The proposed regulations provide that the proceeds taken into account under the private activity bond tests include certain replacement proceeds that are reasonably expected to be available during the project period.

The final regulations treat replaced amounts also as arising to the extent that the issuer reasonably expects that the term of the issue will be longer than is reasonably necessary for the governmental purposes of the issue, in the same manner as replacement proceeds arise under the arbitrage regulations under Code section 148. Thus, replaced amounts may arise under the private activity bond tests if an issuer reasonably expects that there will be available amounts during the period that the bonds remain outstanding longer than necessary for the governmental purposes

of the issue and if those amounts are used for purposes that are inconsistent with the private activity bond tests.

B. Section 1.141-2 Private activity bond tests

1. Clarification of reasonable expectations test. Under the proposed regulations the private activity bond tests depend on both reasonable expectations as of the issue date and subsequent deliberate actions of the issuer.

The final regulations clarify that, in general, the reasonable expectations test is met only if the issuer reasonably expects, as of the issue date, that no action or event during the entire term of the bonds will cause either the private business tests or the private loan financing test to be met. The final regulations further provide, however, that, if certain conditions are met, the period of expected compliance needs to extend only to a mandatory redemption date. This special rule is intended to accommodate issuers that reasonably expect that bond-financed property may be used by nongovernmental persons during the stated term of the issue, but have not entered into any arrangement with a nongovernmental person that will use the property and are unable to predict the timing of that nongovernmental use. This special rule does not permit, however, reasonably expected “recycling” of disposition proceeds because the special rule requires redemption of all nonqualified bonds.

2. Definition of deliberate action. The proposed regulations generally provide that any action within the control of an issuer is treated as a deliberate action and that, if the financed property was designed differently than is reasonably necessary for the governmental purposes of the issuer, an action with respect to that property is treated as deliberate, even if it is not within the issuer’s control. Commentators suggested that deliberate action should be more narrowly defined.

The final regulations make certain changes that narrow the scope of the deliberate action rule to minimize administrative burden on state and local governments. First, the special rule for property that is “designed differently” is deleted. The reasonable expectations test adequately addresses the concerns of this special rule. Second, the final regulations clarify that an action taken by a state or local government in response to a regulatory directive of the federal government is not a deliberate action.

Finally, the final regulations provide that, if certain conditions are met, dispositions of personal property in the ordinary course of an established governmental program are not treated as a deliberate action.

3. Special rule for general obligation bond programs that finance a large number of separate purposes. The proposed regulations provide a special exception to the definition of disposition proceeds that is intended to minimize the administrative burden of tracing the use of proceeds of general obligation bonds that finance a large number of projects. Commentators suggested that this exception should be available for other types of bonds and that fewer conditions should apply to the exception.

The final regulations provide a similar rule that is broadly stated as an exception to the rule that a deliberate action after the issue date can cause an issue to meet the private activity bond tests. This exception is intended to provide relief for “cash flow” general obligation programs, where issuers use the proceeds of an issue for a large number of projects and spend proceeds promptly. These programs merit special treatment in part because they further the purposes of the arbitrage rules.

4. When a deliberate action occurs. The proposed regulations provide that a deliberate action occurs on the earlier of the date the parties agree on the consideration for the new use or the date on which the new use occurs. Commentators suggested that the regulations should not treat a deliberate action as occurring before the date on which new private business use actually commences, in part because it may not be possible to take a remedial action with disposition proceeds before the date on which the disposition proceeds are received.

The final regulations provide in general that a deliberate action occurs on the date the issuer enters into a binding contract with a nongovernmental person for use of the financed property that is not subject to any material contingencies. In most cases, material conditions to closing a transaction that results in private business use will be treated as material contingencies so that this date will not occur before the date of receipt of disposition proceeds.

C. Section 1.141-3 Definition of private business use

1. Economic benefit as private busi-

ness use. Under the proposed regulations, economic benefit to a nongovernmental person may be treated as private business use, even if the nongovernmental person has no special legal rights to use the financed property.

Commentators suggested that the private business use test should not be met unless special legal rights are provided to a nongovernmental person pursuant to an arrangement, and that mere economic benefit is insufficient to give rise to private business use.

The final regulations largely adopt these suggestions. The final regulations provide, however, that, if the financed property is not available for use by the general public, a nongovernmental person may be treated as a private business user of the property based on all of the facts and circumstances, even if that nongovernmental person has no special legal entitlements to use of the property.

2. Ownership. The proposed regulations provide that ownership of property by a nongovernmental person is private business use of that property.

Commentators suggested that ownership for this purpose should be defined to mean ownership for general federal income tax purposes and that mere holding of title to property by a nongovernmental person should not necessarily give rise to private business use. Commentators further suggested that certain customary financing structures that require a nongovernmental person to be a nominal owner of financed property should be accommodated.

The final regulations adopt these suggestions.

3. Discharge of a primary legal obligation. The proposed regulations provide that the use of bond proceeds to provide property that discharges a primary and unconditional legal obligation of a nongovernmental person results in private business use of that property.

Commentators suggested that this rule be deleted from the final regulations. Many commentators indicated that this rule would interfere with traditional tax assessment bond financings for governmental projects such as roads and sidewalks. Some commentators also indicated that certain state and local governments may be required or encouraged under state law to enter into development agreements with private developers that could result in private business use of governmental projects under the discharge of a primary legal obligation rule.

The final regulations adopt this comment by deleting this rule.

4. Management contracts. The proposed regulations provide that management contracts other than qualified management contracts result in private business use of the managed property.

Commentators suggested that the qualified management contract rules should be safe harbors, not substantive rules, and that a management contract should give rise to private business use only if it transfers a proprietary interest in financed property to a manager that is a nongovernmental person. Commentators suggested that the permissible contract terms for qualified management contracts should be further extended and that limitations on the contract term based on useful life of the financed property should be deleted. In addition, commentators suggested that contracts for incidental services, such as janitorial and equipment repair services, should never give rise to private business use of financed property.

The final regulations provide more flexible accommodation for management contracts that implement cost-saving “privatization” measures for state and local governments, but continue to reflect the view that Congress intended that a management contract can give rise to private business use even if it does not in substance transfer a leasehold or ownership interest to a nongovernmental person for general federal income tax purposes. Thus, the final regulations do not adopt the rule that a management contract gives rise to private business use only if it transfers a proprietary interest to a nongovernmental service provider. The final regulations provide that the determination of whether a management contract that does not meet the qualified management contract safe harbors gives rise to private business use is based on all of the facts and circumstances. In general, a management contract gives rise to private business use if the compensation under the contract is based on net profits. The final regulations further provide, however, that contracts for services solely incidental to the primary governmental function or functions of a financed facility do not otherwise give rise to private business use under the management contract rules. In addition, the final regulations clarify the standards to be applied in determining whether a management contract is properly characterized as a lease.

A separate revenue procedure establishes safe harbors which expand the types of management contracts that do not result in private business use. This revenue procedure in particular permits longer term management contracts for public utility facilities and systems, relaxes certain of the requirements for permitted compensation arrangements, and deletes the requirement that the issuer not control the service provider.

5. Research agreements. The proposed regulations set forth bright line rules for determining when corporate-sponsored research agreements and cooperative research agreements do not give rise to private business use. These rules apply only to basic research.

The final regulations provide a facts and circumstances rule, and a separate revenue procedure establishes safe harbors for determining when corporate-sponsored research agreements and cooperative research agreements do not give rise to private business use. This revenue procedure also expands the definition of basic research, for purposes of Code section 141, to include any original investigation for the advancement of scientific knowledge not having a specific commercial objective.

6. Exception for general public use. The proposed regulations contain detailed quantitative rules for determining when use of financed property by a nongovernmental person is disregarded because the nongovernmental person is treated as using the property as a member of the general public. The proposed regulations also provide that use by a nongovernmental person of financed property is not treated as general public use if the property provides a significant economic benefit to the nongovernmental person because it is functionally and integrally related to other property used by the nongovernmental person.

Commentators suggested that the quantitative rules for defining general public use should be deleted, because they are not sufficiently flexible to accommodate the wide variety of state and local government financings and because they disproportionately affect small local governments.

The final regulations largely delete the quantitative approach in the proposed regulations for general public use. Instead, the final regulations adopt a more qualitative test focusing on whether financed property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade

or business. This approach is more consistent with the requirement in Code section 141 that any activity carried on by a person that is not a natural person is treated as a trade or business activity. Because the final regulations generally do not treat mere economic benefit as private business use, the rules for functionally and integrally related property are deleted. In light of this narrower definition of private business use, the special system improvement rules have also been deleted. The final regulations retain the rule in the proposed regulations that use under an arrangement that conveys priority rights is not use on the same basis as the general public and clarifies that an arrangement for long-term use (defined as more than 180 days) is not treated as general public use. The final regulations provide that use of financed property by a nongovernmental person that is not general public use is not necessarily private business use. Under the approach taken in the final regulations, the definition of general public use is significant for determining when economic benefit alone can give rise to private business use and for determining the permitted terms of short-term arrangements that are not treated as private business use.

7. Exceptions for short-term arrangements. The proposed regulations provide that a lease or similar arrangement that has a term of 1 year or less and that is not renewed or renewable is generally disregarded. Commentators suggested that longer term arrangements should be disregarded.

The final regulations provide different exceptions for various short-term contracts. The exceptions for short-term contracts are based on a hierarchy depending on how broadly contracts with the same terms are offered to other users. Under this approach, a contract that is available to the general public may have a term up to 180 days; a contract not treated as general public use, but offered on the basis of generally applicable or uniformly applied rates, may have a term of up to 90 days; and a specially negotiated contract that provides fair market value compensation may have a term of up to 30 days. In each case, the exception applies only if the property is not financed for a principal purpose of providing that property for use by the nongovernmental person entering into the contract. The final regulations delete the 1-year exception for non-renewable short-term contracts because the final regulations adopt a

more flexible rule for measuring private business use, as discussed below.

8. Exception for temporary use by developers. The proposed regulations provide an exception for temporary use by a developer of an improvement that carries out an essential governmental function during an initial development period not exceeding 3 years.

Commentators suggested that the 3-year limitation on the exception is too short for many developments and that a requirement that development proceed with reasonable speed should suffice.

The final regulations largely adopt this comment. This approach focuses more on whether financed property serving an essential governmental function is transferred to a governmental person with reasonable speed than on a specific time frame for development of the property benefited by the improvement.

9. Exceptions for incidental use and qualified improvements. The final regulations remove certain conditions to exceptions for incidental use and qualified improvements.

10. Measurement of private business use. The proposed regulations generally provide that private business use is measured on an annual basis, except for private business use of output facilities. Commentators suggested that private business use should be measured on an average or cumulative basis over the term of an issue.

The final regulations largely adopt the suggestion that private business use should be measured over the term of an issue. In general, the percentage of private business use of financed property is determined according to the average annual private business use of that property over the measurement period. The measurement period begins on the later of the issue date of the issue or the date the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the issue. For certain bonds that are issued in contemplation of refinancing, such as bond anticipation notes, the measurement period is based on the final maturity date of any bond of the refunding issue. Under an anti-abuse rule, however, if an issuer extends the term of an issue for a principal purpose of increasing the permitted amount of private business use, the Commissioner may determine the amount of private business use according to the greatest percentage of private business use in any 1-year period. Fur-

ther, if an issuer reasonably expects on the issue date that bonds will be redeemed before the final maturity of the issue because of a deliberate action, the measurement period ends on the reasonably expected date of redemption. In addition, for arrangements that result in ownership of financed property by a nongovernmental person, the amount of private business use is the greatest percentage of private business use in any 1-year period.

This approach of looking to the average amount of private business use over the expected economic life of financed property is more consistent with the approach adopted for measuring private payments and security, which also in effect looks over the term of an issue. This approach also provides issuers with significantly greater flexibility to spread out *de minimis* private business use over the term of an issue.

The final regulations adopt the measurement-over-the-term rule for private business use, however, only for purposes of determining whether an issue has no more than the permitted amount of private business use (that is, in most cases, the 10 percent threshold). This general approach reflects the view that adoption of the measurement-over-the-term rule for purposes other than the *de minimis* rules would be unduly complex to administer and could distort the economic substance.

This general approach also simplifies the regulations by providing a single rule for measuring private business use that applies to both output facilities and other governmental facilities. The final regulations reflect the view that all governmental facilities generally would benefit from more flexible private business use measurement rules.

11. Determining average use within an annual period. The proposed regulations generally provide that the average amount of private business use within a year is based on the amount of time financed property is actually used for private business use as a percentage of total time for all actual use, provided that significant differences in fair market value of different times of use must be taken into account.

Some commentators suggested that the average amount of private business use should be based on a comparison of time of private business use to time the financed property is available for use, not to time it is actually used.

The final regulations continue to determine private business use for certain

purposes as a percentage of actual use. This method more accurately reflects economic substance. The final regulations also clarify that, in certain cases, the determination of fair market value of private business use must take into account the amount of private payments for that use.

D. Section 1.141-4 Private security or payment test

1. Payments not directly made by private business users. The proposed regulations provide that payments made with respect to property used for a private business use are taken into account under the private payment test, even if not made by persons that are private business users of proceeds. Commentators suggested that payments by persons that are not private business users should be taken into account only if they can be imputed to a private business user of proceeds.

The final regulations retain the general rule in the proposed regulations but clarify that only payments made for the period of private business use are taken into account. The definition of private business use in the final regulations narrows the application of this general rule.

2. Allocation of private payments to different sources of funding. The proposed regulations provide that a payment from a private business user of property may be allocated first to repay any costs of the property paid by the issuer from a source other than a borrowing (“equity”). The proposed regulations also provide, however, that, if a payment is made for property financed with two or more issues (including issues that are not tax-exempt), the payment must be allocated among those issues according to the relative amount of proceeds of those issues used to finance the property. Commentators generally favored the rule permitting allocations first to equity, but suggested that the same rule should apply to costs financed with taxable bonds.

The final regulations provide a more general facts and circumstances test for the allocation of private payments that looks to the nexus between the private payment and both the property financed and the source of funding. Thus, under the approach of the final regulations, allocations of private payments first to equity before other sources of funding are generally permitted only to the extent that there is a specific nexus between the payment and a prior expendi-

ture. The final regulations do not adopt the recommendation that issuers also be permitted in all cases to allocate private payments first to repayment of taxable bonds, but treat the obligation to pay debt service in future years under the taxable debt as establishing a nexus to future private payments. The final regulations retain the rule that allocations of private payments among issues according to relative amounts of those sources of funding that are expended on the property is generally appropriate, but the final regulations provide issuers with more flexibility to match these allocations to debt service payments associated with various sources of funding.

3. Allocation of private security among issues. The proposed regulations provide that, for bonds other than parity bonds, property or payments securing more than one issue must be fully allocated to each issue under the private security test. Commentators suggested that the rule for allocation of private security among issues should reasonably reflect foreclosure and default scenarios under the bond documents. The final regulations in general adopt this comment.

4. Limitations on private security. The proposed regulations provide that any property that is used for a private business use is taken into account under the private security test if it secures payment of debt service on an issue.

The final regulations provide that only financed property and property that is provided directly or indirectly by a nongovernmental person that is treated as a user of proceeds are taken into account under the private security test.

5. Exception for generally applicable taxes. The proposed regulations contain specific rules for when a special agreement with respect to a generally applicable tax may cause tax payments to be treated as private payments.

In response to comments, the final regulations are more flexible for arrangements that reduce the amount of tax paid and permit a wider range of tax equivalency payments. The final regulations also clarify that an impermissible agreement entered into by one taxpayer does not affect whether payments made by other taxpayers are treated as generally applicable taxes.

E. Section 1.141-5 Private loan financing test

1. Definition of proceeds for purposes of the private loan financing test. The proposed regulations provide that the

private loan financing test is met if more than the lesser of 5 percent of the “proceeds” or \$5 million of “sale proceeds” is used to make or finance loans to nongovernmental persons. Commentators suggested that the definition of proceeds for purposes of the test should be consistent.

The final regulations apply the general private activity bond definition of “proceeds” to both parts of the test. This approach reflects the view that investment proceeds that are used to make or finance loans should be taken into account in determining whether the private loan financing test is met.

2. Requirements for the “tax assessment loan” exception. The proposed regulations provide that a number of special requirements apply to the exception in Code section 141(c)(2) from the private loan financing test for loans that enable the borrower to finance a governmental tax or assessment of general application for a specific essential governmental function. Commentators suggested that these requirements would improperly restrict traditional special tax and assessment tax-exempt financing for governmental infrastructure in some states.

In general, special state law restrictions (for example, state constitutional limitations on issuing general obligation bonds) should not necessarily foreclose state and local governments from access to tax-exempt financing for traditional governmental infrastructure projects. Accordingly, the final regulations relax the requirements for the tax assessment bond exception. The requirement that a tax or assessment of general application be proportionate to the benefit to the taxpayer is deleted. Further, the definition of improvements that serve essential governmental functions is expanded. Under the new definition, all improvements to utilities and systems that are owned by a governmental person and that are available for use by the general public serve essential governmental functions for this purpose. In addition, the final regulations provide that guarantees provided by persons treated as borrowers in most cases will not cause taxes or assessments to fail to qualify for the tax assessment bond exception.

F. Section 1.141-6 Allocation and accounting rules

1. Allocations of proceeds to expenditures. The proposed regulations in general provide that proceeds must be allocated to expenditures consistently for

private activity bond purposes and arbitrage purposes. Commentators suggested that, in light of the different purposes of the private activity bond rules and the arbitrage rules, this consistency should not be required.

The final regulations continue the approach of the proposed regulations. Final regulations are also adopted under Code section 148 clarifying that allocations of proceeds to expenditures for both purposes must be made by a definite time (in no event later than the date that rebate is, or would be, due).

2. Other allocation rules. The proposed regulations contain detailed rules in §§ 1.141-1 and 1.141-6 for allocations of proceeds and bonds, including rules for mixed use facilities and partnerships.

The final regulations reserve these provisions. The IRS and Treasury are considering more flexible rules to accommodate public/private partnerships.

G. Section 1.141-7 Special rules for output contracts

The proposed regulations contain detailed rules in § 1.141-7 for determining the private business use and private payments resulting from output contracts.

Regulatory changes are dramatically affecting the electric power industry. In order to further consider the issues raised by these changes, the final regulations reserve this section. The final regulations, however, otherwise apply to bonds issued to finance output facilities.

H. Section 1.141-8 \$15 million limitation for output facilities

Clarification of computation of nonqualified amount. The proposed regulations provide guidance on the special \$15 million limitation on output facilities of Code section 141(b)(4). The final regulations reserve this section.

I. Section 1.141-12 Remedial actions

1. Remedial actions generally. The proposed regulations provide that an action that causes the private business tests or the private loan financing test to be met is not treated as a deliberate action if the issuer takes an appropriate remedial action.

The final regulations clarify that a remedial action affects only compliance with the private activity bond rules relating to use of proceeds and does not affect compliance with rules relating to security or payment. This clarification is

important for purposes of determining the amount of “nonqualified bonds” with respect to which a remedial action must be taken.

2. Relationship of disposition proceeds and remedial actions. The proposed regulations contain separate rules for use of proceeds derived from the disposition of bond-financed property (“disposition proceeds”) and remedial actions. Commentators suggested that the relationship between the disposition proceeds rules and the remedial action rules should be clarified and that, in particular, additional rules should be provided indicating when it is appropriate to treat an issue as financing disposition proceeds rather than the transferred property.

The final regulations take the view that, if an issuer disposes of bond-financed property, it is generally appropriate under Code section 141 for the Commissioner to treat the issue as financing either the transferred property or the disposition proceeds. This is because any disposition of bond-financed property has the potential to transfer the benefits of tax-exempt financing to the purchaser, and the private activity bond rules extend to transactions that have significant potential to transfer these benefits, as well as transactions that actually transfer these benefits. As a matter of administrative convenience, however, the final regulations in certain cases permit an issuer to choose to treat an issue as financing either the transferred property or the disposition proceeds, provided that certain conditions are met that protect against abuse. The final regulations accordingly treat the disposition proceeds rules as conditions to taking certain remedial actions. For example, in order for an issue to be eligible for a remedial action, the disposition proceeds of an issue must generally be treated as proceeds for purposes of the arbitrage regulations.

3. Conditions to taking a remedial action. The proposed regulations provide that an issuer may take a remedial action to prevent bonds of an issue from becoming private activity bonds only if it made certain covenants and certifications on the issue date. Commentators suggested that these specific requirements should be deleted because they are unnecessary in light of standard industry practice to require similar covenants and certifications. The final regulations adopt this comment.

4. Maturity limitations and remedial actions. The proposed regulations provide that an issuer cannot take advantage of certain favorable rules involving disposition proceeds if the weighted average maturity of an issue is greater than 120 percent of the economic life of the financed property. Commentators suggested that use of this 120 percent maturity limitation as a condition to favorable treatment in taking remedial actions is burdensome for issuers of governmental bonds.

The final regulations provide that an issue is eligible for the remedial action rules only if the term of the issue is not longer than is reasonably necessary for the governmental purposes of the issue. To determine whether the term of an issue is unreasonably long, the final regulations adopt the same standard that is used for purposes of determining whether replacement proceeds arise because the term of an issue is unreasonably long under § 1.148-1(c)(4). This standard provides that the 120 percent maturity limitation is a safe harbor, rather than a requirement in all cases.

5. Special rules for identifying disposition proceeds. Under the proposed regulations, many of the rules for remedial actions depend on identification of disposition proceeds. The final regulations clarify how disposition proceeds are to be allocated to an issue when the transferred property has been financed with different sources of funding. In general, the final regulations provide that disposition proceeds should be allocated first to the outstanding bonds that financed the property (both tax-exempt and taxable) in proportion to the outstanding principal amounts of those outstanding bonds. Only amounts in excess of these outstanding principal amounts may be allocated to other sources of funding, such as equity of an issuer or bonds that are no longer outstanding.

6. Redemption and defeasance as remedial actions. The proposed regulations generally provide that redemption and defeasance of nonqualified bonds are permitted remedial actions. In cases where the disposition is exclusively for cash, only the disposition proceeds need to be used to redeem or defease bonds; in other cases, the entire amount of nonqualified bonds is required to be redeemed or defeased. The proposed regulations also provide, however, that defeasance of bonds to a date that is more than six months from the date of a deliberate action is permitted only if the possibility of a disposition was remote

as of the issue date of the bonds. Commentators suggested that this special limitation should be deleted because the remoteness standard is vague and would require governmental issuers to use special call provisions that would substantially increase borrowing costs.

The final regulations delete the “remote possibility” limitation on use of defeasance as a remedial action. Instead, the final regulations permit defeasance as a remedial action only if the first call date of the nonqualified bonds is not greater than 10 1/2 years from the issue date. This limitation presents an administrable standard that will not unduly interfere with customary financing practices of state and local governments, while at the same time preventing improper use of defeasance as a remedial action for bonds that cannot be called for an extended period of time.

7. Alternative qualifying use of a facility as a remedial action. The proposed regulations provide that alternative qualifying use of a bond-financed facility is a permitted remedial action if the facility is used in a manner that meets the requirements for any type of qualified private activity bonds and the bonds are treated as reissued as of the date of the deliberate action for purposes of the tax-exempt bond rules concerning use of bond-financed property. Commentators suggested that for purposes of determining whether bonds that are treated as reissued as of the date of the deliberate action satisfy all of the applicable requirements for qualified bonds, the rules contained in Code section 146 relating to volume cap and the rules contained in Code sections 55 and 57 should not apply. Commentators also suggested that the regulations should clarify whether any limitations are placed on an issuer’s use of disposition proceeds when it chooses to use this remedial action.

The final regulations provide that, in order to qualify for this remedial action, an issuer must deposit any disposition proceeds that it receives into a yield-restricted escrow to pay the nonqualified bonds. This requirement is different than the defeasance remedial action, because an issuer is permitted to leave bonds outstanding until maturity (rather than the first call date) and is not subject to the special 10 1/2-year call protection limitation on the defeasance remedial action. Also, if an issuer chooses to use this rule, it may receive compensation in installments and use any payments received either to pay debt service or to deposit into a yield-restricted escrow to

pay debt service. This requirement is appropriate because it establishes the necessary nexus between the new user and the nonqualified bonds. In effect, the new user is treated, as far as is reasonably practicable, as if it were the conduit borrower of the bond proceeds.

The final regulations also clarify that, for purposes of determining whether nonqualified bonds that are deemed to be reissued meet all of the requirements for qualified private activity bonds, the law in effect on the date of the deliberate action applies. The final regulations do not adopt the suggestion that the rules contained in Code section 146 relating to volume cap and the rules contained in Code sections 55 and 57 should not apply. The IRS and Treasury are issuing a revenue procedure (discussed in paragraph 10 below) to address the change in status of bonds from governmental bonds to qualified private activity bonds and the application of the alternative minimum tax provisions. The final regulations provide that the rules contained in Code section 147(d) relating to the acquisition of existing property do not apply to this remedial action.

8. Nonqualified bonds. The proposed regulations permit an issuer to take a remedial action with respect to a portion of the bonds of an issue, rather than the entire issue. In general, the proposed regulations require that these “nonqualified bonds” be a pro rata portion (among the maturities) of the outstanding bonds of an issue. Commentators suggested that issuers should have greater flexibility to allocate uses of proceeds to bonds when a deliberate action occurs.

The final regulations permit an issuer to redeem or defease bonds with longer maturities than the nonqualified bonds in a remedial action, but in general continue to require that nonqualified bonds be identified on a pro rata basis. Issuers have significant flexibility to allocate bonds of an issue to separate purposes on or before the issue date under § 1.150-1(c)(3).

Under the final regulations, the percentage of outstanding bonds that are nonqualified bonds is equal to the highest percentage of private business use in any 1-year period commencing with the deliberate action.

9. Effect of deliberate actions and remedial actions on bonds that have been advance refunded. The proposed regulations do not specifically address how deliberate actions and remedial actions affect bonds that have been ad-

vance refunded. Commentators suggested that a deliberate action should not affect the status of an advance refunded bond under Code section 141.

The final regulations provide that a remedial action taken with respect to advance refunding bonds proportionately “cures” the bonds that have been advance refunded.

10. Remedial payment revenue procedure. The preamble to the proposed regulations indicates that the IRS and Treasury are considering issuance of a revenue procedure pursuant to which an issuer may request a closing agreement with respect to outstanding bonds. Under the closing agreement, the issuer would make a payment to the IRS to prevent the interest on bonds from being includible in gross income of bondholders as a result of a deliberate action that results in satisfaction of the private activity bond test. In general, the payment would be based on the difference between applicable federal rates for taxable and tax-exempt obligations. The preamble to the proposed regulations indicates that this revenue procedure is being considered in lieu of permitting defeasance as a remedial action. Commentators generally favored the publication of such a revenue procedure but suggested that it should apply in addition to defeasance as a remedial action.

Commentators also suggested that an issuer should be permitted to make a payment to the IRS in those cases where the bonds were issued as governmental bonds, the interest on which was not treated as an item of tax preference for purposes of the alternative minimum tax provisions, but the bonds become qualified private activity bonds, the interest on which is treated as an item of tax preference for purposes of the alternative minimum tax provisions as a consequence of a remedial action taken by the issuer.

The IRS and Treasury are issuing a revenue procedure in addition to permitting defeasance as a remedial action. Under this revenue procedure the amount of the remedial payment is based on a factor that roughly approximates revenue loss to the United States rather than the difference between taxable and tax-exempt applicable federal rates. While this approach may in many cases require greater remedial payments than under the approach described in the proposed regulations, the fluctuation in the difference between taxable and tax-exempt applicable federal rates would result in inconsistent treatment of issu-

ers. Further, a more rigorous standard for determining the remedial payment is appropriate because the revenue procedure is adopted in addition to all of the remedial actions set forth in the final regulations.

In response to comments, this revenue procedure also provides that an issuer may make a payment to prevent the application of the alternative minimum tax provisions to interest payable on bonds that were issued as governmental bonds but, as a consequence of a remedial action taken by an issuer, are qualified private activity bonds. This approach recognizes the difficulty state and local government issuers may have in notifying bondholders of this change in status.

J. Section 1.141-13 Refunding issues

The final regulations reserve on the treatment of refunding bonds under Code section 141.

K. Section 1.141-14 Anti-abuse rules

Application of the rule to override specific tracing. The proposed regulations provide that if an issuer enters into a transaction or series of transactions with a principal purpose of transferring to nongovernmental persons (other than as members of the general public) significant benefits of tax-exempt financing in a manner that is inconsistent with the purposes of Code section 141, the Commissioner may take any action to reflect the substance of the transaction or transactions.

The final regulations adopt this rule and add examples to clarify that it may be invoked in appropriate cases to override specific tracing of the use of proceeds.

L. Section 1.145-1 Special rules for qualified 501(c)(3) bonds

1. Application of private activity bond rules to Code section 145(a). The proposed regulations provide that the regulations under Code section 141 interpreting the private activity bond tests apply for purposes of Code section 145(a)(2).

The final regulations in general continue this approach but also provide that certain provisions under Code section 141, which are intended to apply only to governmental programs, do not apply to qualified 501(c)(3) bonds. The final regulations also clarify that regulations under Code section 141 apply in the same manner to the ownership test of

Code section 145(a)(1) and to the modified private activity bond test of Code section 145(a)(2).

2. Application of deliberate action and remedial action rules to other provisions of Code section 145. The proposed regulations provide that the deliberate action rules of § 1.141-2 and the remedial action rules of § 1.141-12 generally apply to Code section 145.

The final regulations do not apply to Code sections 145(b), (c), or (d). The \$150 million limitation on bonds other than hospital bonds of Code sections 145(b) and (c) involves a number of special considerations, which the IRS and Treasury believe would be more appropriate to consider in a project comprehensively interpreting the operation of the special volume cap rules. Similarly, the restrictions on bonds used to provide residential rental housing for family units of Code section 145(d) involve a number of special considerations, which the IRS and Treasury believe would be more appropriate to consider in a project comprehensively interpreting the special rules for bonds financing residential rental housing.

M. Special rules for other qualified bonds

1. General standard for compliance. The proposed regulations provide that the requirements for qualified bonds (other than qualified 501(c)(3) bonds) generally must be actually met throughout the term of an issue. Commentators suggested that this rule should be deleted because the compliance standard for each type of qualified bond should be separately considered. Other commentators suggested that the compliance standard applicable to governmental bonds, looking to reasonable expectations and deliberate actions, is generally appropriate for qualified bonds.

The final regulations do not address the general compliance standard for qualified bonds (other than qualified 501(c)(3) bonds). The IRS and Treasury believe that further consideration should be given to whether special rules apply to different types of qualified bonds. Accordingly, the final regulations address only whether remedial actions may be taken to prevent certain types of qualified bonds from failing to meet requirements relating to use of proceeds. Thus, no implication is intended that the measurement-over-the-term rule for private business use under Code sections 141 and 145 applies in any manner to other qualified bonds.

2. Remedial actions for change in use. The proposed regulations in general provide that, if an action results in nonqualified use of proceeds, the remedial actions that apply to governmental bonds also apply to qualified bonds. The permitted remedial actions include redemption and defeasance of bonds and alternative qualifying use of a facility.

The final regulations address only whether remedial actions may be taken for exempt facility bonds under Code section 142 and qualified small issue bonds under Code section 144(a) and with respect to certain provisions of 147. The final regulations continue to provide that redemption and defeasance are permitted remedial actions for these types of issues, under rules that are similar to the remedial action rules that apply to governmental bonds. The requirements for these types of qualified bonds focus on the use of a particular facility for a particular qualifying use, and, unlike governmental bonds and qualified 501(c)(3) bonds, do not generally focus on the status of the borrower. For this reason, the final regulations generally do not permit an issuer of exempt facility bonds or qualified small issue bonds to take a remedial action based on use of disposition proceeds. Accordingly, the final regulations clarify that the amount of bonds required to be redeemed or defeased under a remedial action is not limited to the amount of disposition proceeds. For administrative convenience, however, the final regulations permit the use of disposition proceeds from the sale of personal property that is incidental to a qualifying facility to replace the personal property that is sold. The final regulations do not permit alternative qualifying use of a facility as a remedial action for exempt facility bonds or qualified small issue bonds.

3. Remedial actions for failure to spend proceeds. The proposed regulations provide that a remedial action may be taken to correct a failure to spend proceeds as required under Code sections 142 and 144. This rule replaces Rev. Proc. 79-5, 1979-1 C.B. 485, and Rev. Proc. 81-22, 1981-1 C.B. 692, which provide guidance on how the requirement in the predecessor to Code section 142 that substantially all of the proceeds be spent for a qualifying purpose is met when excess bond proceeds remain on hand after acquisition or construction has been completed.

The final regulations clarify that the requirements for remedial action in the case of failure to spend proceeds for a

qualifying purpose are comparable to the requirements for remedial action in the case of change in use of a qualifying facility. Accordingly, the final regulations require that nonqualified bonds must be redeemed at their first call date, regardless of the amount of call premium that is required to be paid, and that defeasance is permitted only if the first call date is no later than 10 1/2 years after the issue date.

4. Refundings of qualified bonds. The final regulations reserve on the treatment of refundings of qualified bonds.

N. Section 1.150-4 Statutory change of use rules for qualified private activity bonds

The proposed regulations provide that the change of use provisions of Code section 150(b) apply even if an issuer takes a remedial action that enables an issue of qualified private activity bonds to continue to meet use of proceeds requirements. Commentators suggested that a remedial action that preserves the tax-exempt status of a qualified private activity bond should also prevent application of the interest deduction denial and imputed unrelated business income provisions of Code section 150(b).

The final regulations more specifically address the effect of each type of remedial action on the application of the Code section 150(b) consequences. In general, defeasance of bonds does not prevent application of Code section 150(b). If other remedial actions are taken promptly after the date of the remedial action, however, Code section 150(b) does not apply.

O. Effective dates

The final regulations generally apply to bonds issued after May 16, 1997. To promote compliance, the final regulations generally permit elective, retroactive application of the regulations in whole, but not in part, to outstanding issues. In addition, the final regulations permit elective, retroactive application to outstanding issues of any of the following sections of the regulations: § 1.141-12 (the remedial action rules); § 1.141-3(b)(4) (the management contract rules); and § 1.141-3(b)(6) (the research agreement rules).

Effect on Other Documents

In part because the existing industrial development bond regulations under § 1.103-7 may continue to apply to refunding bonds issued after the effec-

tive date of the private activity bond regulations, § 1.103-7 is not being removed from the Code of Federal Regulations.

For bonds to which the final regulations apply, the following publications are obsolete:

Notice 87-69, 1987-2 C.B. 378.

Notice 89-9, 1989-1 C.B. 630.

For actions that occur on or after May 16, 1997, the following publications are obsolete:

Rev. Proc. 93-17, 1993-1 C.B. 507.

Rev. Proc. 81-22, 1981-1 C.B. 692.

Rev. Proc. 79-5, 1979-1 C.B. 485.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the notice of proposed rulemaking preceding the regulations was issued prior to March 29, 1996, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Michael G. Bailey, Loretta J. Finger, and Nancy M. Lashnits, Office of Assistant Chief Counsel (Financial Institutions and Products), and Linda B. Schakel of the Office of Tax Legislative Counsel. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.148-6 also issued under 26 U.S.C. 148(f), (g), and (i). * * *

Section 1.150-4 also issued under 26 U.S.C. 150(c)(5). * * *

Par. 2. The center heading immediately preceding § 1.141-1 is revised to read as follows:

TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS

Par. 3. Section 1.141-1 is revised.

§ 1.143-1 [Redesignated as § 1.7703-1]

Par. 4. Section 1.143-1 is redesignated as § 1.7703-1.

§ 1.144-3 [Removed]

Par. 5. Section 1.144-3 is removed.

Par. 6. Sections 1.141-0 and 1.141-2 through 1.141-16 are added.

The revised and added sections read as follows:

§ 1.141-0 Table of contents.

This section lists the captioned paragraphs contained in §§ 1.141-1 through 1.141-16.

§ 1.141-1 Definitions and rules of general application.

- (a) In general.
- (b) Certain general definitions.
- (c) Elections.
- (d) Related parties.

§ 1.141-2 Private activity bond tests.

- (a) Overview.
- (b) Scope.
- (c) General definition of private activity bond.
- (d) Reasonable expectations and deliberate actions.
 - (1) In general.
 - (2) Reasonable expectations test.
 - (3) Deliberate action defined.
 - (4) Special rule for dispositions of personal property in the ordinary course of an established governmental program.
 - (5) Special rule for general obligation bond programs that finance a large number of separate purposes.
- (e) When a deliberate action occurs.
- (f) Certain remedial actions.
- (g) Examples.

§ 1.141-3 Definition of private business use.

- (a) General rule.
 - (1) In general.
 - (2) Indirect use.
 - (3) Aggregation of private business use.
 - (b) Types of private business use arrangements.
 - (1) In general.
 - (2) Ownership.

- (3) Leases.
- (4) Management contracts.
- (5) Output contracts.
- (6) Research agreements.
- (7) Other actual or beneficial use.
- (c) Exception for general public use.
 - (1) In general.
 - (2) Use on the same basis.
 - (3) Long-term arrangements not treated as general public use.
 - (4) Relation to other use.
 - (d) Other exceptions.
 - (1) Agents.
 - (2) Use incidental to financing arrangements.
 - (3) Exceptions for arrangements other than arrangements resulting in ownership of financed property by a nongovernmental person.
 - (4) Temporary use by developers.
 - (5) Incidental use.
 - (6) Qualified improvements.
 - (e) Special rule for tax assessment bonds.
 - (f) Examples.
 - (g) Measurement of private business use.
 - (1) In general.
 - (2) Measurement period.
 - (3) Determining average percentage of private business use.
 - (4) Determining the average amount of private business use for a 1-year period.
 - (5) Common areas.
 - (6) Allocation of neutral costs.
 - (7) Commencement of measurement of private business use.
 - (8) Examples.

§ 1.141-4 Private security or payment test.

- (a) General rule.
 - (1) Private security or payment.
 - (2) Aggregation of private payments and security.
 - (3) Underlying arrangement.
 - (b) Measurement of private payments and security.
 - (1) Scope.
 - (2) Present value measurement.
 - (c) Private payments.
 - (1) In general.
 - (2) Payments taken into account.
 - (3) Allocation of payments.
 - (d) Private security.
 - (1) In general.
 - (2) Security taken into account.
 - (3) Pledge of unexpended proceeds.
 - (4) Secured by any interest in property or payments.
 - (5) Payments in respect of property.

(6) Allocation of security among issues.

(e) Generally applicable taxes.

(1) General rule.

(2) Definition of generally applicable taxes.

(3) Special charges.

(4) Manner of determination and collection.

(5) Payments in lieu of taxes.

(f) Certain waste remediation bonds.

(1) Scope.

(2) Persons that are not private users.

(3) Persons that are private users.

(g) Examples.

§ 1.141-5 *Private loan financing test.*

(a) In general.

(b) Measurement of test.

(c) Definition of private loan.

(1) In general.

(2) Application only to purpose investments.

(3) Grants.

(4) Hazardous waste remediation bonds.

(d) Tax assessment loan exception.

(1) General rule.

(2) Tax assessment loan defined.

(3) Mandatory tax or other assessment.

(4) Specific essential governmental function.

(5) Equal basis requirement.

(6) Coordination with private business tests.

(e) Examples.

§ 1.141-6 *Allocation and accounting rules.*

(a) Allocation of proceeds to expenditures.

(b) Allocation of proceeds to property. [Reserved]

(c) Special rules for mixed use facilities. [Reserved]

(d) Allocation of proceeds to common areas. [Reserved]

(e) Allocation of proceeds to bonds. [Reserved]

(f) Treatment of partnerships. [Reserved]

(g) Examples. [Reserved]

§ 1.141-7 *Special rules for output contracts.*

[Reserved]

§ 1.141-8 *\$15 million limitation for output facilities.*

[Reserved]

§ 1.141-9 *Unrelated or disproportionate use test.*

(a) General rules.

(1) Description of test.

(2) Application of unrelated or disproportionate use test.

(b) Unrelated use.

(1) In general.

(2) Use for the same purpose as government use.

(c) Disproportionate use.

(1) Definition of disproportionate use.

(2) Aggregation of related uses.

(3) Allocation rule.

(d) Maximum use taken into account.

(e) Examples.

§ 1.141-10 *Coordination with volume cap.*

[Reserved]

§ 1.141-11 *Acquisition of nongovernmental output property.*

[Reserved]

§ 1.141-12 *Remedial actions.*

(a) Conditions to taking remedial action.

(1) Reasonable expectations test met.

(2) Maturity not unreasonably long.

(3) Fair market value consideration.

(4) Disposition proceeds treated as gross proceeds for arbitrage purposes.

(5) Proceeds expended on a governmental purpose.

(b) Effect of a remedial action.

(1) In general.

(2) Effect on bonds that have been advance refunded.

(c) Disposition proceeds.

(1) Definition.

(2) Allocating disposition proceeds to an issue.

(3) Allocating disposition proceeds to different sources of funding.

(d) Redemption or defeasance of nonqualified bonds.

(1) In general.

(2) Special rule for dispositions for cash.

(3) Notice of defeasance.

(4) Special limitation.

(5) Defeasance escrow defined.

(e) Alternative use of disposition proceeds.

(1) In general.

(2) Special rule for use by 501(c)(3) organizations.

(f) Alternative use of facility.

(g) Rules for deemed reissuance.

(h) Authority of Commissioner to provide for additional remedial actions.

(i) Effect of remedial action on continuing compliance.

(j) Nonqualified bonds.

(1) Amount of nonqualified bonds.

(2) Allocation of nonqualified bonds.

(k) Examples.

§ 1.141-13 *Refunding issues.*

[Reserved]

§ 1.141-14 *Anti-abuse rules.*

(a) Authority of Commissioner to reflect substance of transactions.

(b) Examples.

§ 1.141-15 *Effective dates.*

(a) Scope.

(b) Effective dates.

(c) Refunding bonds.

(d) Permissive application of regulations.

(e) Permissive retroactive application of certain sections.

§ 1.141-16 *Effective dates for qualified private activity bond provisions.*

(a) Scope.

(b) Effective dates.

(c) Permissive application.

§ 1.141-1 *Definitions and rules of general application.*

(a) *In general.* For purposes of §§ 1.141-0 through 1.141-16, the following definitions and rules apply: the definitions in this section, the definitions in § 1.150-1, the definition of placed in service under § 1.150-2(c), the definition of grant under § 1.148-6(d)(4)(iii), the definition of reasonably required reserve or replacement fund in § 1.148-2(f), and the following definitions under § 1.148-1: bond year, commingled fund, fixed yield issue, higher yielding investments, investment, investment proceeds, issue price, issuer, nonpurpose investment, purpose investment, qualified guarantee, qualified hedge, reasonable expectations or reasonableness, rebate amount, replacement proceeds, sale proceeds, variable yield issue, and yield.

(b) *Certain general definitions.* *Common areas* means portions of a facility that are equally available to all users of a facility on the same basis for uses that are incidental to the primary use of the facility. For example, hallways and elevators generally are treated as common areas if they are used by the different lessees of a facility in connection with the primary use of that facility.

Consistently applied means applied uniformly to account for proceeds and other amounts.

Deliberate action is defined in § 1.141–2(d)(3).

Discrete portion means a portion of a facility that consists of any separate and discrete portion of a facility to which use is limited, other than common areas. A floor of a building and a portion of a building separated by walls, partitions, or other physical barriers are examples of a discrete portion.

Disposition is defined in § 1.141–12(c)(1).

Disposition proceeds is defined in § 1.141–12(c)(1).

Essential governmental function is defined in § 1.141–5(d)(4)(ii).

Financed means constructed, reconstructed, or acquired with proceeds of an issue.

Governmental bond means a bond issued as part of an issue no portion of which consists of private activity bonds.

Governmental person means a state or local governmental unit as defined in § 1.103–1 or any instrumentality thereof. It does not include the United States or any agency or instrumentality thereof.

Hazardous waste remediation bonds is defined in § 1.141–4(f)(1).

Measurement period is defined in § 1.141–3(g)(2).

Nongovernmental person means a person other than a governmental person.

Output facility means electric and gas generation, transmission, distribution, and related facilities, and water collection, storage, and distribution facilities.

Private business tests means the private business use test and the private security or payment test of section 141(b).

Proceeds means the sale proceeds of an issue (other than those sale proceeds used to retire bonds of the issue that are not deposited in a reasonably required reserve or replacement fund). Proceeds also include any investment proceeds from investments that accrue during the project period (net of rebate amounts attributable to the project period). Disposition proceeds of an issue are treated as proceeds to the extent provided in § 1.141–12. The Commissioner may treat any replaced amounts as proceeds.

Project period means the period beginning on the issue date and ending on the date that the project is placed in service. In the case of a multipurpose issue, the issuer may elect to treat the

project period for the entire issue as ending on either the expiration of the temporary period described in § 1.148–2(e)(2) or the end of the fifth bond year after the issue date.

Public utility property means public utility property as defined in section 168(i)(10).

Qualified bond means a qualified bond as defined in section 141(e).

Renewal option means a provision under which either party has a legally enforceable right to renew the contract. Thus, for example, a provision under which a contract is automatically renewed for 1-year periods absent cancellation by either party is not a renewal option (even if it is expected to be renewed).

Replaced amounts means replacement proceeds other than amounts that are treated as replacement proceeds solely because they are sinking funds or pledged funds.

Weighted average maturity is determined under section 147(b).

Weighted average reasonably expected economic life is determined under section 147(b). The reasonably expected economic life of property may be determined by reference to the class life of the property under section 168.

(c) *Elections*. Elections must be made in writing on or before the issue date and retained as part of the bond documents, and, once made, may not be revoked without the permission of the Commissioner.

(d) *Related parties*. Except as otherwise provided, all related parties are treated as one person and any reference to “person” includes any related party.

§ 1.141–2 Private activity bond tests.

(a) *Overview*. Interest on a private activity bond is not excludable from gross income under section 103(a) unless the bond is a qualified bond. The purpose of the private activity bond tests of section 141 is to limit the volume of tax-exempt bonds that finance the activities of nongovernmental persons, without regard to whether a financing actually transfers benefits of tax-exempt financing to a nongovernmental person. The private activity bond tests serve to identify arrangements that have the potential to transfer the benefits of tax-exempt financing, as well as arrangements that actually transfer these benefits. The regulations under section 141 may not be applied in a manner that is inconsistent with these purposes.

(b) *Scope*. Sections 1.141–0 through 1.141–16 apply generally for purposes of the private activity bond limitations under section 141.

(c) *General definition of private activity bond*. Under section 141, bonds are private activity bonds if they meet either the private business use test and private security or payment test of section 141(b) or the private loan financing test of section 141(c). The private business use and private security or payment tests are described in §§ 1.141–3 and 1.141–4. The private loan financing test is described in § 1.141–5.

(d) *Reasonable expectations and deliberate actions*—(1) *In general*. An issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either the private business tests or the private loan financing test. An issue is also an issue of private activity bonds if the issuer takes a deliberate action, subsequent to the issue date, that causes the conditions of either the private business tests or the private loan financing test to be met.

(2) *Reasonable expectations test*—(i) *In general*. In general, the reasonable expectations test must take into account reasonable expectations about events and actions over the entire stated term of an issue.

(ii) *Special rule for issues with mandatory redemption provisions*. An action that is reasonably expected, as of the issue date, to occur after the issue date and to cause either the private business tests or the private loan financing test to be met may be disregarded for purposes of those tests if—

(A) The issuer reasonably expects, as of the issue date, that the financed property will be used for a governmental purpose for a substantial period before the action;

(B) The issuer is required to redeem all nonqualifying bonds (regardless of the amount of disposition proceeds actually received) within 6 months of the date of the action;

(C) The issuer does not enter into any arrangement with a nongovernmental person, as of the issue date, with respect to that specific action; and

(D) The mandatory redemption of bonds meets all of the conditions for remedial action under § 1.141–12(a).

(3) *Deliberate action defined*—(i) *In general*. Except as otherwise provided in this paragraph (d)(3), a deliberate action is any action taken by the issuer that is within its control. An intent to violate

the requirements of section 141 is not necessary for an action to be deliberate.

(ii) *Safe harbor exceptions.* An action is not treated as a deliberate action if—

(A) It would be treated as an involuntary or compulsory conversion under section 1033; or

(B) It is taken in response to a regulatory directive made by the federal government.

(4) *Special rule for dispositions of personal property in the ordinary course of an established governmental program—(i) In general.* Dispositions of personal property in the ordinary course of an established governmental program are not treated as deliberate actions if—

(A) The weighted average maturity of the bonds financing that personal property is not greater than 120 percent of the reasonably expected actual use of that property for governmental purposes;

(B) The issuer reasonably expects on the issue date that the fair market value of that property on the date of disposition will be not greater than 25 percent of its cost; and

(C) The property is no longer suitable for its governmental purposes on the date of disposition.

(ii) *Reasonable expectations test.* The reasonable expectation that a disposition described in paragraph (d)(4)(i) of this section may occur in the ordinary course while the bonds are outstanding will not cause the issue to meet the private activity bond tests if the issuer is required to deposit amounts received from the disposition in a commingled fund with substantial tax or other governmental revenues and the issuer reasonably expects to spend the amounts on governmental programs within 6 months from the date of commingling.

(iii) *Separate issue treatment.* An issuer may treat the bonds properly allocable to the personal property eligible for this exception as a separate issue under § 1.150-1(c)(3).

(5) *Special rule for general obligation bond programs that finance a large number of separate purposes.* The determination of whether bonds of an issue are private activity bonds may be based solely on the issuer's reasonable expectations as of the issue date if all of the requirements of paragraphs (d)(5)(i) through (vii) of this section are met.

(i) The issue is an issue of general obligation bonds of a general purpose governmental unit that finances at least 25 separate purposes (as defined in

§ 1.150-1(c)(3)) and does not predominantly finance fewer than 4 separate purposes.

(ii) The issuer has adopted a fund method of accounting for its general governmental purposes that makes tracing the bond proceeds to specific expenditures unreasonably burdensome.

(iii) The issuer reasonably expects on the issue date to allocate all of the net proceeds of the issue to capital expenditures within 6 months of the issue date and adopts reasonable procedures to verify that net proceeds are in fact so expended. A program to randomly spot check that 10 percent of the net proceeds were so expended generally is a reasonable verification procedure for this purpose.

(iv) The issuer reasonably expects on the issue date to expend all of the net proceeds of the issue before expending proceeds of a subsequent issue of similar general obligation bonds.

(v) The issuer reasonably expects on the issue date that it will not make any loans to nongovernmental persons with the proceeds of the issue.

(vi) The issuer reasonably expects on the issue date that the capital expenditures that it could make during the 6-month period beginning on the issue date with the net proceeds of the issue that would not meet the private business tests are not less than 125 percent of the capital expenditures to be financed with the net proceeds of the issue.

(vii) The issuer reasonably expects on the issue date that the weighted average maturity of the issue is not greater than 120 percent of the weighted average reasonably expected economic life of the capital expenditures financed with the issue. To determine reasonably expected economic life for this purpose an issuer may use reasonable estimates based on the type of expenditures made from a fund.

(e) *When a deliberate action occurs.* A deliberate action occurs on the date the issuer enters into a binding contract with a nongovernmental person for use of the financed property that is not subject to any material contingencies.

(f) *Certain remedial actions.* See § 1.141-12 for certain remedial actions that prevent a deliberate action with respect to property financed by an issue from causing that issue to meet the private business use test or the private loan financing test.

(g) *Examples.* The following examples illustrate the application of this section:

Example 1. Involuntary action. City B issues bonds to finance the purchase of land. On the issue date, B reasonably expects that it will be the sole user of the land for the entire term of the bonds. Subsequently, the federal government acquires the land in a condemnation action. B sets aside the condemnation proceeds to pay debt service on the bonds but does not redeem them on their first call date. The bonds are not private activity bonds because B has not taken a deliberate action after the issue date. See, however, § 1.141-14(b), *Example 2.*

Example 2. Reasonable expectations test— involuntary action. The facts are the same as in *Example 1*, except that, on the issue date, B reasonably expects that the federal government will acquire the land in a condemnation action during the term of the bonds. On the issue date, the present value of the amount that B reasonably expects to receive from the federal government is greater than 10 percent of the present value of the debt service on the bonds. The terms of the bonds do not require that the bonds be redeemed within 6 months of the acquisition by the federal government. The bonds are private activity bonds because the issuer expects as of the issue date that the private business tests will be met.

Example 3. Reasonable expectations test— mandatory redemption. City C issues bonds to rehabilitate an existing hospital that it currently owns. On the issue date of the bonds, C reasonably expects that the hospital will be used for a governmental purpose for a substantial period. On the issue date, C also plans to construct a new hospital, but the placed in service date of that new hospital is uncertain. C reasonably expects that, when the new hospital is placed in service, it will sell or lease the rehabilitated hospital to a private hospital corporation. The bond documents require that the bonds must be redeemed within 6 months of the sale or lease of the rehabilitated hospital (regardless of the amount actually received from the sale). The bonds meet the reasonable expectations requirement of the private activity bond tests if the mandatory redemption of bonds meets all of the conditions for a remedial action under § 1.141-12(a).

Example 4. Dispositions in the ordinary course of an established governmental program. City D issues bonds with a weighted average maturity of 6 years for the acquisition of police cars. D reasonably expects on the issue date that the police cars will be used solely by its police department, except that, in the ordinary course of its police operations, D sells its police cars to a taxicab corporation after 5 years of use because they are no longer suitable for police use. Further, D reasonably expects that the value of the police cars when they are no longer suitable for police use will be no more than 25 percent of cost. D subsequently sells 20 percent of the police cars after only 3 years of actual use. At that time, D deposits the proceeds from the sale of the police cars in a commingled fund with substantial tax revenues and reasonably expects to spend the proceeds on governmental programs within 6 months of the date of deposit. D does not trace the actual use of these commingled amounts. The sale of the police cars does not cause the private activity bond tests to be met because the requirements of paragraph (d)(4) of this section are met.

§ 1.141-3 *Definition of private business use.*

(a) *General rule—(1) In general.* The private business use test relates to the

use of the proceeds of an issue. The 10 percent private business use test of section 141(b)(1) is met if more than 10 percent of the proceeds of an issue is used in a trade or business of a nongovernmental person. For this purpose, the use of financed property is treated as the direct use of proceeds. Any activity carried on by a person other than a natural person is treated as a trade or business. Unless the context or a provision clearly requires otherwise, this section also applies to the private business use test under sections 141(b)(3) (unrelated or disproportionate use), 141(b)(4) (\$15 million limitation for certain output facilities), and 141(b)(5) (the coordination with the volume cap where the nonqualified amount exceeds \$15 million).

(2) *Indirect use.* In determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct uses of proceeds. For example, a facility is treated as being used for a private business use if it is leased to a nongovernmental person and subleased to a governmental person or if it is leased to a governmental person and then subleased to a nongovernmental person, provided that in each case the nongovernmental person's use is in a trade or business. Similarly, the issuer's use of the proceeds to engage in a series of financing transactions for property to be used by nongovernmental persons in their trades or businesses may cause the private business use test to be met. In addition, proceeds are treated as used in the trade or business of a nongovernmental person if a nongovernmental person, as a result of a single transaction or a series of related transactions, uses property acquired with the proceeds of an issue.

(3) *Aggregation of private business use.* The use of proceeds by all nongovernmental persons is aggregated to determine whether the private business use test is met.

(b) *Types of private business use arrangements—(1) In general.* Both actual and beneficial use by a nongovernmental person may be treated as private business use. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or

beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

(2) *Ownership.* Except as provided in paragraph (d)(1) or (d)(2) of this section, ownership by a nongovernmental person of financed property is private business use of that property. For this purpose, ownership refers to ownership for federal income tax purposes.

(3) *Leases.* Except as provided in paragraph (d) of this section, the lease of financed property to a nongovernmental person is private business use of that property. For this purpose, any arrangement that is properly characterized as a lease for federal income tax purposes is treated as a lease. In determining whether a management contract is properly characterized as a lease, it is necessary to consider all of the facts and circumstances, including the following factors—

(i) The degree of control over the property that is exercised by a nongovernmental person; and

(ii) Whether a nongovernmental person bears risk of loss of the financed property.

(4) *Management contracts—(i) Facts and circumstances test.* Except as provided in paragraph (d) of this section, a management contract (within the meaning of paragraph (b)(4)(ii) of this section) with respect to financed property may result in private business use of that property, based on all of the facts and circumstances. A management contract with respect to financed property generally results in private business use of that property if the contract provides for compensation for services rendered with compensation based, in whole or in part, on a share of net profits from the operation of the facility.

(ii) *Management contract defined.* For purposes of this section, a management contract is a management, service, or incentive payment contract between a governmental person and a service provider under which the service provider provides services involving all, a portion of, or any function of, a facility. For example, a contract for the provision of management services for an entire hospital, a contract for management services for a specific department of a hospital, and an incentive payment contract for physician services to patients of a hospital are each treated as a management contract.

(iii) *Arrangements generally not treated as management contracts.* The arrangements described in paragraphs (b)(4)(iii)(A) through (D) of this section generally are not treated as management contracts that give rise to private business use.

(A) Contracts for services that are solely incidental to the primary governmental function or functions of a financed facility (for example, contracts for janitorial, office equipment repair, hospital billing, or similar services).

(B) The mere granting of admitting privileges by a hospital to a doctor, even if those privileges are conditioned on the provision of de minimis services, if those privileges are available to all qualified physicians in the area, consistent with the size and nature of its facilities.

(C) A contract to provide for the operation of a facility or system of facilities that consists predominantly of public utility property, if the only compensation is the reimbursement of actual and direct expenses of the service provider and reasonable administrative overhead expenses of the service provider.

(D) A contract to provide for services, if the only compensation is the reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties.

(iv) *Management contracts that are properly treated as other types of private business use.* A management contract with respect to financed property results in private business use of that property if the service provider is treated as the lessee or owner of financed property for federal income tax purposes, unless an exception under paragraph (d) of this section applies to the arrangement.

(5) *Output contracts.* See § 1.141-7 for special rules for contracts for the purchase of output of output facilities.

(6) *Research agreements—(i) Facts and circumstances test.* Except as provided in paragraph (d) of this section, an agreement by a nongovernmental person to sponsor research performed by a governmental person may result in private business use of the property used for the research, based on all of the facts and circumstances.

(ii) *Research agreements that are properly treated as other types of private business use.* A research agreement with respect to financed property results in private business use of that property if the sponsor is treated as the lessee or

owner of financed property for federal income tax purposes, unless an exception under paragraph (d) of this section applies to the arrangement.

(7) *Other actual or beneficial use—*

(i) *In general.* Any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to special legal entitlements described in paragraphs (b)(2), (3), (4), (5), or (6) of this section results in private business use. For example, an arrangement that conveys priority rights to the use or capacity of a facility generally results in private business use.

(ii) *Special rule for facilities not used by the general public.* In the case of financed property that is not available for use by the general public (within the meaning of paragraph (c) of this section), private business use may be established solely on the basis of a special economic benefit to one or more nongovernmental persons, even if those nongovernmental persons have no special legal entitlements to use of the property. In determining whether special economic benefit gives rise to private business use it is necessary to consider all of the facts and circumstances, including one or more of the following factors—

(A) Whether the financed property is functionally related or physically proximate to property used in the trade or business of a nongovernmental person;

(B) Whether only a small number of nongovernmental persons receive the special economic benefit; and

(C) Whether the cost of the financed property is treated as depreciable by any nongovernmental person.

(c) *Exception for general public use—*(1) *In general.* Use as a member of the general public (general public use) is not private business use. Use of financed property by nongovernmental persons in their trades or businesses is treated as general public use only if the property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business.

(2) *Use on the same basis.* In general, use under an arrangement that conveys priority rights or other preferential benefits is not use on the same basis as the general public. Arrangements providing for use that is available to the general public at no charge or on the basis of rates that are generally applicable and uniformly applied do not convey priority rights or other preferen-

tial benefits. For this purpose, rates may be treated as generally applicable and uniformly applied even if—

(i) Different rates apply to different classes of users, such as volume purchasers, if the differences in rates are customary and reasonable; or

(ii) A specially negotiated rate arrangement is entered into, but only if the user is prohibited by federal law from paying the generally applicable rates, and the rates established are as comparable as reasonably possible to the generally applicable rates.

(3) *Long-term arrangements not treated as general public use.* An arrangement is not treated as general public use if the term of the use under the arrangement, including all renewal options, is greater than 180 days. For this purpose, a right of first refusal to renew use under the arrangement is not treated as a renewal option if—

(i) The compensation for the use under the arrangement is redetermined at generally applicable, fair market value rates that are in effect at the time of renewal; and

(ii) The use of the financed property under the same or similar arrangements is predominantly by natural persons who are not engaged in a trade or business.

(4) *Relation to other use.* Use of financed property by the general public does not prevent the proceeds from being used for a private business use because of other use under this section.

(d) *Other exceptions—*(1) *Agents.* Use of proceeds by nongovernmental persons solely in their capacity as agents of a governmental person is not private business use. For example, use by a nongovernmental person that issues obligations on behalf of a governmental person is not private business use to the extent the nongovernmental person's use of proceeds is in its capacity as an agent of the governmental person.

(2) *Use incidental to financing arrangements.* Use by a nongovernmental person that is solely incidental to a financing arrangement is not private business use. A use is solely incidental to a financing arrangement only if the nongovernmental person has no substantial rights to use bond proceeds or financed property other than as an agent of the bondholders. For example, a nongovernmental person that acts solely as an owner of title in a sale and leaseback financing transaction with a city generally is not a private business user of the property leased to the city, provided that the nongovernmental per-

son has assigned all of its rights to use the leased facility to the trustee for the bondholders upon default by the city. Similarly, bond trustees, servicers, and guarantors are generally not treated as private business users.

(3) *Exceptions for arrangements other than arrangements resulting in ownership of financed property by a nongovernmental person—*(i) *Arrangements not available for use on the same basis by natural persons not engaged in a trade or business.* Use by a nongovernmental person pursuant to an arrangement, other than an arrangement resulting in ownership of financed property by a nongovernmental person, is not private business use if—

(A) The term of the use under the arrangement, including all renewal options, is not longer than 90 days;

(B) The arrangement would be treated as general public use, except that it is not available for use on the same basis by natural persons not engaged in a trade or business because generally applicable and uniformly applied rates are not reasonably available to natural persons not engaged in a trade or business; and

(C) The property is not financed for a principal purpose of providing that property for use by that nongovernmental person.

(ii) *Negotiated arm's-length arrangements.* Use by a nongovernmental person pursuant to an arrangement, other than an arrangement resulting in ownership of financed property by a nongovernmental person, is not private business use if—

(A) The term of the use under the arrangement, including all renewal options, is not longer than 30 days;

(B) The arrangement is a negotiated arm's-length arrangement, and compensation under the arrangement is at fair market value; and

(C) The property is not financed for a principal purpose of providing that property for use by that nongovernmental person.

(4) *Temporary use by developers.* Use during an initial development period by a developer of an improvement that carries out an essential governmental function is not private business use if the issuer and the developer reasonably expect on the issue date to proceed with all reasonable speed to develop the improvement and property benefited by that improvement and to transfer the improvement to a governmental person, and if the improvement is in fact trans-

ferred to a governmental person promptly after the property benefited by the improvement is developed.

(5) *Incidental use*—(i) *General rule.* Incidental uses of a financed facility are disregarded, to the extent that those uses do not exceed 2.5 percent of the proceeds of the issue used to finance the facility. A use of a facility by a nongovernmental person is incidental if—

(A) Except for vending machines, pay telephones, kiosks, and similar uses, the use does not involve the transfer to the nongovernmental person of possession and control of space that is separated from other areas of the facility by walls, partitions, or other physical barriers, such as a night gate affixed to a structural component of a building (a nonpossessory use);

(B) The nonpossessory use is not functionally related to any other use of the facility by the same person (other than a different nonpossessory use); and

(C) All nonpossessory uses of the facility do not, in the aggregate, involve the use of more than 2.5 percent of the facility.

(ii) *Illustrations.* Incidental uses may include pay telephones, vending machines, advertising displays, and use for television cameras, but incidental uses may not include output purchases.

(6) *Qualified improvements.* Proceeds that provide a governmentally owned improvement to a governmentally owned building (including its structural components and land functionally related and subordinate to the building) are not used for a private business use if—

(i) The building was placed in service more than 1 year before the construction or acquisition of the improvement is begun;

(ii) The improvement is not an enlargement of the building or an improvement of interior space occupied exclusively for any private business use;

(iii) No portion of the improved building or any payments in respect of the improved building are taken into account under section 141(b)(2)(A) (the private security test); and

(iv) No more than 15 percent of the improved building is used for a private business use.

(e) *Special rule for tax assessment bonds.* In the case of a tax assessment bond that satisfies the requirements of § 1.141-5(d), the loan (or deemed loan) of the proceeds to the borrower paying the assessment is disregarded in determining whether the private business use

test is met. However, the use of the loan proceeds is not disregarded in determining whether the private business use test is met.

(f) *Examples.* The following examples illustrate the application of paragraphs (a) through (e) of this section. In each example, assume that the arrangements described are the only arrangements with nongovernmental persons for use of the financed property.

Example 1. Nongovernmental ownership. State A issues 20-year bonds to purchase land and equip and construct a factory. A then enters into an arrangement with Corporation X to sell the factory to X on an installment basis while the bonds are outstanding. The issue meets the private business use test because a nongovernmental person owns the financed facility. See also § 1.141-2 (relating to the private activity bond tests), and § 1.141-5 (relating to the private loan financing test).

Example 2. Lease to a nongovernmental person. (i) The facts are the same as in Example 1, except that A enters into an arrangement with X to lease the factory to X for 3 years rather than to sell it to X. The lease payments will be made annually and will be based on the tax-exempt interest rate on the bonds. The issue meets the private business use test because a nongovernmental person leases the financed facility. See also § 1.141-14 (relating to anti-abuse rules).

(ii) The facts are the same as in Example 2(i), except that the annual payments made by X will equal fair rental value of the facility and exceed the amount necessary to pay debt service on the bonds for the 3 years of the lease. The issue meets the private business use test because a nongovernmental person leases the financed facility and the test does not require that the benefits of tax-exempt financing be passed through to the nongovernmental person.

Example 3. Management contract in substance a lease. City L issues 30-year bonds to finance the construction of a city hospital. L enters into a 15-year contract with M, a nongovernmental person that operates a health maintenance organization relating to the treatment of M's members at L's hospital. The contract provides for reasonable fixed compensation to M for services rendered with no compensation based, in whole or in part, on a share of net profits from the operation of the hospital. However, the contract also provides that 30 percent of the capacity of the hospital will be exclusively available to M's members and M will bear the risk of loss of that portion of the capacity of the hospital so that, under all of the facts and circumstances, the contract is properly characterized as a lease for federal income tax purposes. The issue meets the private business use test because a nongovernmental person leases the financed facility.

Example 4. Ownership of title in substance a leasehold interest. Nonprofit corporation R issues bonds on behalf of City P to finance the construction of a hospital. R will own legal title to the hospital. In addition, R will operate the hospital, but R is not treated as an agent of P in its capacity as operator of the hospital. P has certain rights to the hospital that establish that it is properly treated as the owner of the property for federal income tax purposes. P does not have rights, however, to directly control operation of the hospital while R owns legal title to it and operates it. The issue meets the private business use test because the arrangement provides a nongovernmental person

an interest in the financed facility that is comparable to a leasehold interest. See paragraphs (a)(2) and (b)(7)(i) of this section.

Example 5. Rights to control use of property treated as private business use—parking lot. Corporation C and City D enter into a plan to finance the construction of a parking lot adjacent to C's factory. Pursuant to the plan, C conveys the site for the parking lot to D for a nominal amount, subject to a covenant running with the land that the property be used only for a parking lot. In addition, D agrees that C will have the right to approve rates charged by D for use of the parking lot. D issues bonds to finance construction of the parking lot on the site. The parking lot will be available for use by the general public on the basis of rates that are generally applicable and uniformly applied. The issue meets the private business use test because a nongovernmental person has special legal entitlements for beneficial use of the financed facility that are comparable to an ownership interest. See paragraph (b)(7)(i) of this section.

Example 6. Other actual or beneficial use—hydroelectric enhancements. J, a political subdivision, owns and operates a hydroelectric generation plant and related facilities. Pursuant to a take or pay contract, J sells 15 percent of the output of the plant to Corporation K, an investor-owned utility. K is treated as a private business user of the plant. Under the license issued to J for operation of the plant, J is required by federal regulations to construct and operate various facilities for the preservation of fish and for public recreation. J issues its obligations to finance the fish preservation and public recreation facilities. K has no special legal entitlements for beneficial use of the financed facilities. The fish preservation facilities are functionally related to the operation of the plant. The recreation facilities are available to natural persons on a short-term basis according to generally applicable and uniformly applied rates. Under paragraph (c) of this section, the recreation facilities are treated as used by the general public. Under paragraph (b)(7) of this section, K's use is not treated as private business use of the recreation facilities because K has no special legal entitlements for beneficial use of the recreation facilities. The fish preservation facilities are not of a type reasonably available for use on the same basis by natural persons not engaged in a trade or business. Under all of the facts and circumstances (including the functional relationship of the fish preservation facilities to property used in K's trade or business) under paragraph (b)(7)(ii) of this section, K derives a special economic benefit from the fish preservation facilities. Therefore, K's private business use may be established solely on the basis of that special economic benefit, and K's use of the fish preservation facilities is treated as private business use.

Example 7. Other actual or beneficial use—pollution control facilities. City B issues obligations to finance construction of a specialized pollution control facility on land that it owns adjacent to a factory owned by Corporation N. B will own and operate the pollution control facility, and N will have no special legal entitlements to use the facility. B, however, reasonably expects that N will be the only user of the facility. The facility will not be reasonably available for use on the same basis by natural persons not engaged in a trade or business. Under paragraph (b)(7)(ii) of this section, because under all of the facts and circumstances the facility is functionally related and is physically proximate to property used in N's trade or business, N derives a special economic benefit from the facility. Therefore, N's

private business use may be established solely on the basis of that special economic benefit, and N's use is treated as private business use of the facility. See paragraph (b)(7)(ii) of this section.

Example 8. General public use—airport runway. (i) City I issues bonds and uses all of the proceeds to finance construction of a runway at a new city-owned airport. The runway will be available for take-off and landing by any operator of an aircraft desiring to use the airport, including general aviation operators who are natural persons not engaged in a trade or business. It is reasonably expected that most of the actual use of the runway will be by private air carriers (both charter airlines and commercial airlines) in connection with their use of the airport terminals leased by those carriers. These leases for the use of terminal space provide no priority rights or other preferential benefits to the air carriers for use of the runway. Moreover, under the leases the lease payments are determined without taking into account the revenues generated by runway landing fees (that is, the lease payments are not determined on a "residual" basis). Although the lessee air carriers receive a special economic benefit from the use of the runway, this economic benefit is not sufficient to cause the air carriers to be private business users, because the runway is available for general public use. The issue does not meet the private business use test. See paragraphs (b)(7)(ii) and (c) of this section.

(ii) The facts are the same as in *Example 8(i)*, except that the runway will be available for use only by private air carriers. The use by these private air carriers is not general public use, because the runway is not reasonably available for use on the same basis by natural persons not engaged in a trade or business. Depending on all of the facts and circumstances, including whether there are only a small number of lessee private air carriers, the issue may meet the private business use test solely because the private air carriers receive a special economic benefit from the runway. See paragraph (b)(7)(ii) of this section.

(iii) The facts are the same as in *Example 8(i)*, except that the lease payments under the leases with the private air carriers are determined on a residual basis by taking into account the net revenues generated by runway landing fees. These leases cause the private business use test to be met with respect to the runway because they are arrangements that convey special legal entitlements to the financed facility to nongovernmental persons. See paragraph (b)(7)(i) of this section.

Example 9. General public use—airport parking garage. City S issues bonds and uses all of the proceeds to finance construction of a city-owned parking garage at the city-owned airport. S reasonably expects that more than 10 percent of the actual use of the parking garage will be by employees of private air carriers (both charter airlines and commercial airlines) in connection with their use of the airport terminals leased by those carriers. The air carriers' use of the parking garage, however, will be on the same basis as passengers and other members of the general public using the airport. The leases for the use of the terminal space provide no priority rights to the air carriers for use of the parking garage, and the lease payments are determined without taking into account the revenues generated by the parking garage. Although the lessee air carriers receive a special economic benefit from the use of the parking garage, this economic benefit is not sufficient to cause the air carriers to be private business users, because the parking garage is available for general public use. The issue does

not meet the private business use test. See paragraphs (b)(7)(ii) and (c) of this section.

Example 10. Long-term arrangements not treated as general public use—insurance fund. Authority T deposits all of the proceeds of its bonds in its insurance fund and invests all of those proceeds in tax-exempt bonds. The insurance fund provides insurance to a large number of businesses and natural persons not engaged in a trade or business. Each participant receives insurance for a term of 1 year. The use by the participants, other than participants that are natural persons not engaged in a trade or business, is treated as private business use of the proceeds of the bonds because the participants have special legal entitlements to the use of bond proceeds, even though the contractual rights are not necessarily properly characterized as ownership, leasehold, or similar interests listed in paragraph (b) of this section. Use of the bond proceeds is not treated as general public use because the term of the insurance is greater than 180 days. See paragraphs (b)(7)(i) and (c)(3) of this section.

Example 11. General public use—port road. Highway Authority W uses all of the proceeds of its bonds to construct a 25-mile road to connect an industrial port owned by Corporation Y with existing roads owned and operated by W. Other than the port, the nearest residential or commercial development to the new road is 12 miles away. There is no reasonable expectation that development will occur in the area surrounding the new road. W and Y enter into no arrangement (either by contract or ordinance) that conveys special legal entitlements to Y for the use of the road. Use of the road will be available without restriction to all users, including natural persons who are not engaged in a trade or business. The issue does not meet the private business use test because the road is treated as used only by the general public.

Example 12. General public use of governmentally owned hotel. State Q issues bonds to purchase land and construct a hotel for use by the general public (that is, tourists, visitors, and business travelers). The bond documents provide that Q will own and operate the project for the term of the bonds. Q will not enter into a lease or license with any user for use of rooms for a period longer than 180 days (although users may actually use rooms for consecutive periods in excess of 180 days). Use of the hotel by hotel guests who are travelling in connection with trades or businesses of nongovernmental persons is not a private business use of the hotel by these persons because the hotel is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business. See paragraph (c)(1) of this section.

Example 13. General public use with rights of first refusal. Authority V uses all of the proceeds of its bonds to construct a parking garage. At least 90 percent of the spaces in the garage will be available to the general public on a monthly first-come, first-served basis. V reasonably expects that the spaces will be predominantly leased to natural persons not engaged in a trade or business who have priority rights to renew their spaces at then current fair market value rates. More than 10 percent of the spaces will be leased to nongovernmental persons acting in a trade or business. These leases are not treated as arrangements with a term of use greater than 180 days. The rights to renew are not treated as renewal options because the compensation for the spaces is redetermined at generally applicable, fair market value rates that will be in effect at the time of renewal and the use of the spaces under similar arrangements is predominantly by natural persons who are not en-

gaged in a trade or business. The issue does not meet the private business use test because at least 90 percent of the use of the parking garage is general public use. See paragraph (c)(3) of this section.

Example 14. General public use with a specially negotiated rate agreement with agency of United States. G, a sewage collection and treatment district, operates facilities that were financed with its bonds. F, an agency of the United States, has a base located within G. Approximately 20 percent of G's facilities are used to treat sewage produced by F under a specially negotiated rate agreement. Under the specially negotiated rate agreement, G uses its best efforts to charge F as closely as possible the same amount for its use of G's services as its other customers pay for the same amount of services, although those other customers pay for services based on standard district charges and tax levies. F is prohibited by federal law from paying for the services based on those standard district charges and tax levies. The use of G's facilities by F is on the same basis as the general public. See paragraph (c)(2)(ii) of this section.

Example 15. Arrangements not available for use by natural persons not engaged in a trade or business—federal use of prisons. Authority E uses all of the proceeds of its bonds to construct a prison. E contracts with federal agency F to house federal prisoners on a space-available, first-come, first-served basis, pursuant to which F will be charged approximately the same amount for each prisoner as other persons that enter into similar transfer agreements. It is reasonably expected that other persons will enter into similar agreements. The term of the use under the contract is not longer than 90 days, and F has no right to renew, although E reasonably expects to renew the contract indefinitely. The prison is not financed for a principal purpose of providing the prison for use by F. It is reasonably expected that during the term of the bonds, more than 10 percent of the prisoners at the prison will be federal prisoners. F's use of the facility is not general public use because this type of use (leasing space for prisoners) is not available for use on the same basis by natural persons not engaged in a trade or business. The issue does not meet the private business use test, however, because the leases satisfy the exception of paragraph (d)(3)(i) of this section.

Example 16. Negotiated arm's-length arrangements—auditorium reserved in advance. (i) City Z issues obligations to finance the construction of a municipal auditorium that it will own and operate. The use of the auditorium will be open to anyone who wishes to use it for a short period of time on a rate-scale basis. Z reasonably expects that the auditorium will be used by schools, church groups, sororities, and numerous commercial organizations. Corporation H, a nongovernmental person, enters into an arm's-length arrangement with Z to use the auditorium for 1 week for each year for a 10-year period (a total of 70 days), pursuant to which H will be charged a specific price reflecting fair market value. On the date the contract is entered into, Z has not established generally applicable rates for future years. Even though the auditorium is not financed for a principal purpose of providing use of the auditorium to H, H is not treated as using the auditorium as a member of the general public because its use is not on the same basis as the general public. Because the term of H's use of the auditorium is longer than 30 days, the arrangement does not meet the exception under paragraph (d)(3)(ii) of this section.

(ii) The facts are the same as in *Example 16(i)*, except that H will enter into an arm's-length arrangement with Z to use the auditorium for 1 week for each year for a 4-year period (a total of 28 days), pursuant to which H will be charged a specific price reflecting fair market value. H is not treated as a private business user of the auditorium because its contract satisfies the exception of paragraph (d)(3)(ii) of this section for negotiated arm's-length arrangements.

(g) *Measurement of private business use*—(1) *In general*. In general, the private business use of proceeds is allocated to property under § 1.141-6. The amount of private business use of that property is determined according to the average percentage of private business use of that property during the measurement period.

(2) *Measurement period*—(i) *General rule*. Except as provided in this paragraph (g)(2), the measurement period of property financed by an issue begins on the later of the issue date of that issue or the date the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the issue financing the property (determined without regard to any optional redemption dates). In general, the period of reasonably expected economic life of the property for this purpose is based on reasonable expectations as of the issue date.

(ii) *Special rule for refundings of short-term obligations*. For an issue of short-term obligations that the issuer reasonably expects to refund with a long-term financing (such as bond anticipation notes), the measurement period is based on the latest maturity date of any bond of the last refunding issue with respect to the financed property (determined without regard to any optional redemption dates).

(iii) *Special rule for reasonably expected mandatory redemptions*. If an issuer reasonably expects on the issue date that an action will occur during the term of the bonds to cause either the private business tests or the private loan financing test to be met and is required to redeem bonds to meet the reasonable expectations test of § 1.141-2(d)(2), the measurement period ends on the reasonably expected redemption date.

(iv) *Special rule for ownership by a nongovernmental person*. The amount of private business use resulting from ownership by a nongovernmental person is the greatest percentage of private business use in any 1-year period.

(v) *Anti-abuse rule*. If an issuer establishes the term of an issue for a period that is longer than is reasonably necessary for the governmental purposes of the issue for a principal purpose of increasing the permitted amount of private business use, the Commissioner may determine the amount of private business use according to the greatest percentage of private business use in any 1-year period.

(3) *Determining average percentage of private business use*. The average percentage of private business use is the average of the percentages of private business use during the 1-year periods within the measurement period. Appropriate adjustments must be made for beginning and ending periods of less than 1 year.

(4) *Determining the average amount of private business use for a 1-year period*—(i) *In general*. The percentage of private business use of property for any 1-year period is the average private business use during that year. This average is determined by comparing the amount of private business use during the year to the total amount of private business use and use that is not private business use (government use) during that year. Paragraphs (g)(4)(ii) through (v) of this section apply to determine the average amount of private business use for a 1-year period.

(ii) *Uses at different times*. For a facility in which actual government use and private business use occur at different times (for example, different days), the average amount of private business use generally is based on the amount of time that the facility is used for private business use as a percentage of the total time for all actual use. In determining the total amount of actual use, periods during which the facility is not in use are disregarded.

(iii) *Simultaneous use*. In general, for a facility in which government use and private business use occur simultaneously, the entire facility is treated as having private business use. For example, a governmentally owned facility that is leased or managed by a nongovernmental person in a manner that results in private business use is treated as entirely used for a private business use. If, however, there is also private business use and actual government use on the same basis, the average amount of private business use may be determined on a reasonable basis that properly reflects the proportionate benefit to be derived by the various users of the

facility (for example, reasonably expected fair market value of use). For example, the average amount of private business use of a garage with unassigned spaces that is used for government use and private business use is generally based on the number of spaces used for private business use as a percentage of the total number of spaces.

(iv) *Discrete portion*. For purposes of this paragraph (g), measurement of the use of proceeds allocated to a discrete portion of a facility is determined by treating that discrete portion as a separate facility.

(v) *Relationship to fair market value*. For purposes of paragraphs (g)(4)(ii) through (iv) of this section, if private business use is reasonably expected as of the issue date to have a significantly greater fair market value than government use, the average amount of private business use must be determined according to the relative reasonably expected fair market values of use rather than another measure, such as average time of use. This determination of relative fair market value may be made as of the date the property is acquired or placed in service if making this determination as of the issue date is not reasonably possible (for example, if the financed property is not identified on the issue date). In general, the relative reasonably expected fair market value for a period must be determined by taking into account the amount of reasonably expected payments for private business use for the period in a manner that properly reflects the proportionate benefit to be derived from the private business use.

(5) *Common areas*. The amount of private business use of common areas within a facility is based on a reasonable method that properly reflects the proportionate benefit to be derived by the users of the facility. For example, in general, a method that is based on the average amount of private business use of the remainder of the entire facility reflects proportionate benefit.

(6) *Allocation of neutral costs*. Proceeds that are used to pay costs of issuance, invested in a reserve or replacement fund, or paid as fees for a qualified guarantee or a qualified hedge must be allocated ratably among the other purposes for which the proceeds are used.

(7) *Commencement of measurement of private business use*. Generally, private business use commences on the first date on which there is a right to actual use by the nongovernmental per-

son. However, if an issuer enters into an arrangement for private business use a substantial period before the right to actual private business use commences and the arrangement transfers ownership or is an arrangement for other long-term use (such as a lease for a significant portion of the remaining economic life of financed property), private business use commences on the date the arrangement is entered into, even if the right to actual use commences after the measurement period. For this purpose, 10 percent of the measurement period is generally treated as a substantial period.

(8) *Examples.* The following examples illustrate the application of this paragraph (g):

Example 1. Research facility. University U, a state owned and operated university, owns and operates a research facility. U proposes to finance general improvements to the facility with the proceeds of an issue of bonds. U enters into sponsored research agreements with nongovernmental persons that result in private business use because the sponsors will own title to any patents resulting from the research. The governmental research conducted by U and the research U conducts for the sponsors take place simultaneously in all laboratories within the research facility. All laboratory equipment is available continuously for use by workers who perform both types of research. Because it is not possible to predict which research projects will be successful, it is not reasonably practicable to estimate the relative revenues expected to result from the governmental and nongovernmental research. U contributed 90 percent of the cost of the facility and the nongovernmental persons contributed 10 percent of the cost. Under this section, the nongovernmental persons are using the facility for a private business use on the same basis as the government use of the facility. The portions of the costs contributed by the various users of the facility provide a reasonable basis that properly reflects the proportionate benefit to be derived by the users of the facility. The nongovernmental persons are treated as using 10 percent of the proceeds of the issue.

Example 2. Stadium. (i) City L issues bonds and uses all of the proceeds to construct a stadium. L enters into a long-term contract with a professional sports team T under which T will use the stadium 20 times during each year. These uses will occur on nights and weekends. L reasonably expects that the stadium will be used more than 180 other times each year, none of which will give rise to private business use. This expectation is based on a feasibility study and historical use of the old stadium that is being replaced by the new stadium. There is no significant difference in the value of T's uses when compared to the other uses of the stadium, taking into account the payments that T is reasonably expected to make for its use. Assuming no other private business use, the issue does not meet the private business use test because not more than 10 percent of the use of the facility is for a private business use.

(ii) The facts are the same as in Example 2(i), except that L reasonably expects that the stadium will be used not more than 60 other times each year, none of which will give rise to private business use. The issue meets the private business

use test because 25 percent of the proceeds are used for a private business use.

Example 3. Airport terminal areas treated as common areas. City N issues bonds to finance the construction of an airport terminal. Eighty percent of the leasable space of the terminal will be leased to private air carriers. The remaining 20 percent of the leasable space will be used for the term of the bonds by N for its administrative purposes. The common areas of the terminal, including waiting areas, lobbies, and hallways are treated as 80 percent used by the air carriers for purposes of the private business use test.

§ 1.141-4 Private security or payment test.

(a) *General rule*—(1) *Private security or payment.* The private security or payment test relates to the nature of the security for, and the source of, the payment of debt service on an issue. The private payment portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly to be derived from payments (whether or not to the issuer or any related party) in respect of property, or borrowed money, used or to be used for a private business use. The private security portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly secured by any interest in property used or to be used for a private business use or payments in respect of property used or to be used for a private business use. For additional rules for output facilities, see § 1.141-7.

(2) *Aggregation of private payments and security.* For purposes of the private security or payment test, payments taken into account as private payments and payments or property taken into account as private security are aggregated. However, the same payments are not taken into account as both private security and private payments.

(3) *Underlying arrangement.* The security for, and payment of debt service on, an issue is determined from both the terms of the bond documents and on the basis of any underlying arrangement. An underlying arrangement may result from separate agreements between the parties or may be determined on the basis of all of the facts and circumstances surrounding the issuance of the bonds. For example, if the payment of debt service on an issue is secured by both a pledge of the full faith and credit of a state or local governmental unit and any interest in property used or to be used in a private business use, the issue meets the private security or payment test.

(b) *Measurement of private payments and security*—(1) *Scope.* This paragraph

(b) contains rules that apply to both private security and private payments.

(2) *Present value measurement*—(i) *Use of present value.* In determining whether an issue meets the private security or payment test, the present value of the payments or property taken into account is compared to the present value of the debt service to be paid over the term of the issue.

(ii) *Debt service*—(A) *Debt service paid from proceeds.* Debt service does not include any amount paid or to be paid from sale proceeds or investment proceeds. For example, debt service does not include payments of capitalized interest funded with proceeds.

(B) *Adjustments to debt service.* Debt service is adjusted to take into account payments and receipts that adjust the yield on an issue for purposes of section 148(f). For example, debt service includes fees paid for qualified guarantees under § 1.148-4(f) and is adjusted to take into account payments and receipts on qualified hedges under § 1.148-4(h).

(iii) *Computation of present value*—(A) *In general.* Present values are determined by using the yield on the issue as the discount rate and by discounting all amounts to the issue date. See, however, § 1.141-13 for special rules for refunding bonds.

(B) *Fixed yield issues.* For a fixed yield issue, yield is determined on the issue date and is not adjusted to take into account subsequent events.

(C) *Variable yield issues.* The yield on a variable yield issue is determined over the term of the issue. To determine the reasonably expected yield as of any date, the issuer may assume that the future interest rate on a variable yield bond will be the then-current interest rate on the bonds determined under the formula prescribed in the bond documents. A deliberate action requires a recomputation of the yield on the variable yield issue to determine the present value of payments under that arrangement. In that case, the issuer must use the yield determined as of the date of the deliberate action for purposes of determining the present value of payments under the arrangement causing the deliberate action. See paragraph (g) of this section, *Example 3.*

(iv) *Application to private security.* For purposes of determining the present value of debt service that is secured by property, the property is valued at fair market value as of the first date on which the property secures bonds of the issue.

(c) *Private payments*—(1) *In general.* This paragraph (c) contains rules that apply to private payments.

(2) *Payments taken into account*—(i) *Payments for use*—(A) *In general.* Both direct and indirect payments made by any nongovernmental person that is treated as using proceeds of the issue are taken into account as private payments to the extent allocable to the proceeds used by that person. Payments are taken into account as private payments only to the extent that they are made for the period of time that proceeds are used for a private business use. Payments for a use of proceeds include payments (whether or not to the issuer) in respect of property financed (directly or indirectly) with those proceeds, even if not made by a private business user. Payments are not made in respect of financed property if those payments are directly allocable to other property being directly used by the person making the payment and those payments represent fair market value compensation for that other use. See paragraph (g) of this section, *Example 4* and *Example 5*. See also paragraph (c)(3) of this section for rules relating to allocation of payments to the source or sources of funding of property.

(B) *Payments not to exceed use.* Payments with respect to proceeds that are used for a private business use are not taken into account to the extent that the present value of those payments exceeds the present value of debt service on those proceeds. Payments need not be directly derived from a private business user, however, to be taken into account. Thus, if 7 percent of the proceeds of an issue is used by a person over the measurement period, payments with respect to the property financed with those proceeds are taken into account as private payments only to the extent that the present value of those payments does not exceed the present value of 7 percent of the debt service on the issue.

(C) *Payments for operating expenses.* Payments by a person for a use of proceeds do not include the portion of any payment that is properly allocable to the payment of ordinary and necessary expenses (as defined under section 162) directly attributable to the operation and maintenance of the financed property used by that person. For this purpose, general overhead and administrative expenses are not directly attributable to those operations and maintenance. For example, if an issuer receives \$5,000 rent during the year for use of

space in a financed facility and during the year pays \$500 for ordinary and necessary expenses properly allocable to the operation and maintenance of that space and \$400 for general overhead and general administrative expenses properly allocable to that space, \$500 of the \$5,000 received would not be considered a payment for the use of the proceeds allocable to that space (regardless of the manner in which that \$500 is actually used).

(ii) *Refinanced debt service.* Payments of debt service on an issue to be made from proceeds of a refunding issue are taken into account as private payments in the same proportion that the present value of the payments taken into account as private payments for the refunding issue bears to the present value of the debt service to be paid on the refunding issue. For example, if all the debt service on a note is paid with proceeds of a refunding issue, the note meets the private security or payment test if (and to the same extent that) the refunding issue meets the private security or payment test. This paragraph (c)(2)(ii) does not apply to payments that arise from deliberate actions that occur more than 3 years after the retirement of the prior issue that are not reasonably expected on the issue date of the refunding issue. For purposes of this paragraph (c)(2)(ii), whether an issue is a refunding issue is determined without regard to § 1.150-1(d)(2)(i) (relating to certain payments of interest).

(3) *Allocation of payments*—(i) *In general.* Private payments for the use of property are allocated to the source or different sources of funding of property. The allocation to the source or different sources of funding is based on all of the facts and circumstances, including whether an allocation is consistent with the purposes of section 141. In general, a private payment for the use of property is allocated to a source of funding based upon the nexus between the payment and both the financed property and the source of funding. For this purpose, different sources of funding may include different tax-exempt issues, taxable issues, and amounts that are not derived from a borrowing, such as revenues of an issuer (equity).

(ii) *Payments for use of discrete property.* Payments for the use of a discrete facility (or a discrete portion of a facility) are allocated to the source or different sources of funding of that discrete property.

(iii) *Allocations among two or more sources of funding.* In general, except as provided in paragraphs (c)(3)(iv) and (v) of this section, if a payment is made for the use of property financed with two or more sources of funding (for example, equity and a tax-exempt issue), that payment must be allocated to those sources of funding in a manner that reasonably corresponds to the relative amounts of those sources of funding that are expended on that property. If an issuer has not retained records of amounts expended on the property (for example, records of costs of a building that was built 30 years before the allocation), an issuer may use reasonable estimates of those expenditures. For this purpose, costs of issuance and other similar neutral costs are allocated ratably among expenditures in the same manner as in § 1.141-3(g)(6). A payment for the use of property may be allocated to two or more issues that finance property according to the relative amounts of debt service (both paid and accrued) on the issues during the annual period for which the payment is made, if that allocation reasonably reflects the economic substance of the arrangement. In general, allocations of payments according to relative debt service reasonably reflect the economic substance of the arrangement if the maturity of the bonds reasonably corresponds to the reasonably expected economic life of the property and debt service payments on the bonds are approximately level from year to year.

(iv) *Payments made under an arrangement entered into in connection with issuance of bonds.* A private payment for the use of property made under an arrangement that is entered into in connection with the issuance of the issue that finances that property generally is allocated to that issue. Whether an arrangement is entered into in connection with the issuance of an issue is determined on the basis of all of the facts and circumstances. An arrangement is ordinarily treated as entered into in connection with the issuance of an issue if—

(A) The issuer enters into the arrangement during the 3-year period beginning 18 months before the issue date; and

(B) The amount of payments reflects all or a portion of debt service on the issue.

(v) *Allocations to equity.* A private payment for the use of property may be

allocated to equity before payments are allocated to an issue only if—

(A) Not later than 60 days after the date of the expenditure of those amounts, the issuer adopts an official intent (in a manner comparable to § 1.150-2(e)) indicating that the issuer reasonably expects to be repaid for the expenditure from a specific arrangement; and

(B) The private payment is made not later than 18 months after the later of the date the expenditure is made or the date the project is placed in service.

(d) *Private security*—(1) *In general.* This paragraph (d) contains rules that relate to private security.

(2) *Security taken into account.* The property that is the security for, or the source of, the payment of debt service on an issue need not be property financed with proceeds. For example, unimproved land or investment securities used, directly or indirectly, in a private business use that secures an issue provides private security. Private security (other than financed property and private payments) for an issue is taken into account under section 141(b), however, only to the extent it is provided, directly or indirectly, by a user of proceeds of the issue.

(3) *Pledge of unexpended proceeds.* Proceeds qualifying for an initial temporary period under § 1.148-2(e)(2) or (3) or deposited in a reasonably required reserve or replacement fund (as defined in § 1.148-2(f)(2)(i)) are not taken into account under this paragraph (d) before the date on which those amounts are either expended or loaned by the issuer to an unrelated party.

(4) *Secured by any interest in property or payments.* Property used or to be used for a private business use and payments in respect of that property are treated as private security if any interest in that property or payments secures the payment of debt service on the bonds. For this purpose, the phrase any interest in is to be interpreted broadly and includes, for example, any right, claim, title, or legal share in property or payments.

(5) *Payments in respect of property.* The payments taken into account as private security are payments in respect of property used or to be used for a private business use. Except as otherwise provided in this paragraph (d)(5) and paragraph (d)(6) of this section, the rules in paragraphs (c)(2)(i)(A) and (B) and (c)(2)(ii) of this section apply to determine the amount of payments

treated as payments in respect of property used or to be used for a private business use. Thus, payments made by members of the general public for use of a facility used for a private business use (for example, a facility that is the subject of a management contract that results in private business use) are taken into account as private security to the extent that they are made for the period of time that property is used by a private business user.

(6) *Allocation of security among issues.* In general, property or payments from the disposition of that property that are taken into account as private security are allocated to each issue secured by the property or payments on a reasonable basis that takes into account bondholders' rights to the payments or property upon default.

(e) *Generally applicable taxes*—(1) *General rule.* For purposes of the private security or payment test, generally applicable taxes are not taken into account (that is, are not payments from a nongovernmental person and are not payments in respect of property used for a private business use).

(2) *Definition of generally applicable taxes.* A generally applicable tax is an enforced contribution exacted pursuant to legislative authority in the exercise of the taxing power that is imposed and collected for the purpose of raising revenue to be used for governmental purposes. A generally applicable tax must have a uniform tax rate that is applied to all persons of the same classification in the appropriate jurisdiction and a generally applicable manner of determination and collection.

(3) *Special charges.* A payment for a special privilege granted or service rendered is not a generally applicable tax. Special assessments paid by property owners benefiting from financed improvements are not generally applicable taxes. For example, a tax or a payment in lieu of tax that is limited to the property or persons benefited by an improvement is not a generally applicable tax.

(4) *Manner of determination and collection*—(i) *In general.* A tax does not have a generally applicable manner of determination and collection to the extent that one or more taxpayers make any impermissible agreements relating to payment of those taxes. An impermissible agreement relating to the payment of a tax is taken into account whether or not it is reasonably expected to result in any payments that would not otherwise

have been made. For example, if an issuer uses proceeds to make a grant to a taxpayer to improve property, agreements that impose reasonable conditions on the use of the grant do not cause a tax on that property to fail to be a generally applicable tax. If an agreement by a taxpayer causes the tax imposed on that taxpayer not to be treated as a generally applicable tax, the entire tax paid by that taxpayer is treated as a special charge, unless the agreement is limited to a specific portion of the tax.

(ii) *Impermissible agreements.* The following are examples of agreements that cause a tax to fail to have a generally applicable manner of determination and collection: an agreement to be personally liable on a tax that does not generally impose personal liability, to provide additional credit support such as a third party guarantee, or to pay unanticipated shortfalls; an agreement regarding the minimum market value of property subject to property tax; and an agreement not to challenge or seek deferral of the tax.

(iii) *Permissible agreements.* The following are examples of agreements that do not cause a tax to fail to have a generally applicable manner of determination and collection: an agreement to use a grant for specified purposes (whether or not that agreement is secured); a representation regarding the expected value of the property following the improvement; an agreement to insure the property and, if damaged, to restore the property; a right of a grantor to rescind the grant if property taxes are not paid; and an agreement to reduce or limit the amount of taxes collected to further a bona fide governmental purpose. For example, an agreement to abate taxes to encourage a property owner to rehabilitate property in a distressed area is a permissible agreement.

(5) *Payments in lieu of taxes.* A tax equivalency payment and any other payment in lieu of a tax is treated as a generally applicable tax if—

(i) The payment is commensurate with and not greater than the amounts imposed by a statute for a tax of general application; and

(ii) The payment is designated for a public purpose and is not a special charge (as described in paragraph (e)(3) of this section). For example, a payment in lieu of taxes made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge.

(f) *Certain waste remediation bonds*—(1) *Scope*. This paragraph (f) applies to bonds issued to finance hazardous waste clean-up activities on privately owned land (hazardous waste remediation bonds).

(2) *Persons that are not private users*. Payments from nongovernmental persons who are not (other than coincidentally) either users of the site being remediated or persons potentially responsible for disposing of hazardous waste on that site are not taken into account as private security. This paragraph (f)(2) applies to payments that secure (directly or indirectly) the payment of principal of, or interest on, the bonds under the terms of the bonds. This paragraph (f)(2) applies only if the payments are made pursuant to either a generally applicable state or local taxing statute or a state or local statute that regulates or restrains activities on an industry-wide basis of persons who are engaged in generating or handling hazardous waste, or in refining, producing, or transporting petroleum, provided that those payments do not represent, in substance, payment for the use of proceeds. For this purpose, a state or local statute that imposes payments that have substantially the same character as those described in Chapter 38 of the Code are treated as generally applicable taxes.

(3) *Persons that are private users*. If payments from nongovernmental persons who are either users of the site being remediated or persons potentially responsible for disposing of hazardous waste on that site do not secure (directly or indirectly) the payment of principal of, or interest on, the bonds under the terms of the bonds, the payments are not taken into account as private payments. This paragraph (f)(3) applies only if at the time the bonds are issued the payments from those nongovernmental persons are not material to the security for the bonds. For this purpose, payments are not material to the security for the bonds if—

(i) The payments are not required for the payment of debt service on the bonds;

(ii) The amount and timing of the payments are not structured or designed to reflect the payment of debt service on the bonds;

(iii) The receipt or the amount of the payment is uncertain (for example, as of the issue date, no final judgment has been entered into against the nongovernmental person);

(iv) The payments from those nongovernmental persons, when and if received, are used either to redeem bonds of the issuer or to pay for costs of any hazardous waste remediation project; and

(v) In the case when a judgment (but not a final judgment) has been entered by the issue date against a nongovernmental person, there are, as of the issue date, costs of hazardous waste remediation other than those financed with the bonds that may be financed with the payments.

(g) *Examples*. The following examples illustrate the application of this section:

Example 1. Aggregation of payments. State B issues bonds with proceeds of \$10 million. B uses \$9.7 million of the proceeds to construct a 10-story office building. B uses the remaining \$300,000 of proceeds to make a loan to Corporation Y. In addition, Corporation X leases 1 floor of the building for the term of the bonds. Under all of the facts and circumstances, it is reasonable to allocate 10 percent of the proceeds to that 1 floor. As a percentage of the present value of the debt service on the bonds, the present value of Y's loan repayments is 3 percent and the present value of X's lease payments is 8 percent. The bonds meet the private security or payment test because the private payments taken into account are more than 10 percent of the present value of the debt service on the bonds.

Example 2. Indirect private payments. J, a political subdivision of a state, will issue several series of bonds from time to time and will use the proceeds to rehabilitate urban areas. Under all of the facts and circumstances, the private business use test will be met with respect to each issue that will be used for the rehabilitation and construction of buildings that will be leased or sold to nongovernmental persons for use in their trades or businesses. Nongovernmental persons will make payments for these sales and leases. There is no limitation either on the number of issues or the aggregate amount of bonds that may be outstanding. No group of bondholders has any legal claim prior to any other bondholders or creditors with respect to specific revenues of J, and there is no arrangement whereby revenues from a particular project are paid into a trust or constructive trust, or sinking fund, or are otherwise segregated or restricted for the benefit of any group of bondholders. There is, however, an unconditional obligation by J to pay the principal of, and the interest on, each issue. Although not directly pledged under the terms of the bond documents, the leases and sales are underlying arrangements. The payments relating to these leases and sales are taken into account as private payments to determine whether each issue of bonds meets the private security or payment test.

Example 3. Computation of payment in variable yield issues. (i) City M issues general obligation bonds with proceeds of \$10 million to finance a 5-story office building. The bonds bear interest at a variable rate that is recomputed monthly according to an index that reflects current market yields. The yield that the interest index would produce on the issue date is 6 percent. M leases 1 floor of the office building to Corporation T, a nongovernmental person, for the term of the bonds. Under all of the facts and circumstances, T is treated as using

more than 10 percent of the proceeds. Using the 6 percent yield as the discount rate, M reasonably expects on the issue date that the present value of lease payments to be made by T will be 8 percent of the present value of the total debt service on the bonds. After the issue date of the bonds, interest rates decline significantly, so that the yield on the bonds over their entire term is 4 percent. Using this actual 4 percent yield as the discount rate, the present value of lease payments made by T is 12 percent of the present value of the actual total debt service on the bonds. The bonds are not private activity bonds because M reasonably expected on the issue date that the bonds would not meet the private security or payment test and because M did not take any subsequent deliberate action to meet the private security or payment test.

(ii) The facts are the same as *Example 3(i)*, except that 5 years after the issue date M leases a second floor to Corporation S, a nongovernmental person, under a long-term lease. Because M has taken a deliberate action, the present value of the lease payments must be computed. On the date this lease is entered into, M reasonably expects that the yield on the bonds over their entire term will be 5.5 percent, based on actual interest rates to date and the then-current rate on the variable yield bonds. M uses this 5.5 percent yield as the discount rate. Using this 5.5 percent yield as the discount rate, as a percentage of the present value of the debt service on the bonds, the present value of the lease payments made by S is 3 percent. The bonds are private activity bonds because the present value of the aggregate private payments is greater than 10 percent of the present value of debt service.

Example 4. Payments not in respect of financed property. In order to further public safety, City Y issues tax assessment bonds the proceeds of which are used to move existing electric utility lines underground. Although the utility lines are owned by a nongovernmental utility company, that company is under no obligation to move the lines. The debt service on the bonds will be paid using assessments levied by City Y on the customers of the utility. Although the utility lines are privately owned and the utility customers make payments to the utility company for the use of those lines, the assessments are payments in respect of the cost of relocating the utility line. Thus, the assessment payments are not made in respect of property used for a private business use. Any direct or indirect payments to Y by the utility company for the undergrounding are, however, taken into account as private payments.

Example 5. Payments from users of proceeds that are not private business users taken into account. City P issues general obligation bonds to finance the renovation of a hospital that it owns. The hospital is operated for P by D, a nongovernmental person, under a management contract that results in private business use under § 1.141-3. P will use the revenues from the hospital (after the required payments to D and the payment of operation and maintenance expenses) to pay the debt service on the bonds. The bonds meet the private security or payment test because the revenues from the hospital are payments in respect of property used for a private business use.

Example 6. Limitation of amount of payments to amount of private business use not determined annually. City Q issues bonds with a term of 15 years and uses the proceeds to construct an office building. The debt service on the bonds is level throughout the 15-year term. Q enters into a 5-year lease with Corporation R under which R is treated as a user of 11 percent of the proceeds. R will make lease payments equal to 20 percent of

the annual debt service on the bonds for each year of the lease. The present value of R's lease payments is equal to 12 percent of the present value of the debt service over the entire 15-year term of the bonds. If, however, the lease payments taken into account as private payments were limited to 11 percent of debt service paid in each year of the lease, the present value of these payments would be only 8 percent of the debt service on the bonds over the entire term of the bonds. The bonds meet the private security or payment test, because R's lease payments are taken into account as private payments in an amount not to exceed 11 percent of the debt service of the bonds.

Example 7. Allocation of payments to funds not derived from a borrowing. City Z purchases property for \$1,250,000 using \$1,000,000 of proceeds of its tax increment bonds and \$250,000 of other revenues that are in its redevelopment fund. Within 60 days of the date of purchase, Z declared its intent to sell the property pursuant to a redevelopment plan and to use that amount to reimburse its redevelopment fund. The bonds are secured only by the incremental property taxes attributable to the increase in value of the property from the planned redevelopment of the property. Within 18 months after the issue date, Z sells the financed property to Developer M for \$250,000, which Z uses to reimburse the redevelopment fund. The property that M uses is financed both with the proceeds of the bonds and Z's redevelopment fund. The payments by M are properly allocable to the costs of property financed with the amounts in Z's redevelopment fund. See paragraphs (c)(3)(i) and (v) of this section.

Example 8. Allocation of payments to different sources of funding—improvements. In 1997, City L issues bonds with proceeds of \$8 million to finance the acquisition of a building. In 2002, L spends \$2 million of its general revenues to improve the heating system and roof of the building. At that time, L enters into a 10-year lease with Corporation M for the building providing for annual payments of \$1 million to L. The lease payments are at fair market value, and the lease payments do not otherwise have a significant nexus to either the issue or to the expenditure of general revenues. Eighty percent of each lease payment is allocated to the issue and is taken into account under the private payment test because each lease payment is properly allocated to the sources of funding in a manner that reasonably corresponds to the relative amounts of the sources of funding that are expended on the building.

Example 9. Security not provided by users of proceeds not taken into account. County W issues certificates of participation in a lease of a building that W owns and covenants to appropriate annual payments for the lease. A portion of each payment is specified as interest. More than 10 percent of the building is used for private business use. None of the proceeds of the obligations are used with respect to the building. W uses the proceeds of the obligations to make a grant to Corporation Y for the construction of a factory that Y will own. Y makes no payments to W, directly or indirectly, for its use of proceeds, and Y has no relationship to the users of the leased building. If W defaults under the lease, the trustee for the holders of the certificates of participation has a limited right of repossession under which the trustee may not foreclose but may lease the property to a new tenant at fair market value. The obligations are secured by an interest in property used for a private business use. However, because the property is not provided by a private business user and

is not financed property, the obligations do not meet the private security or payment test.

Example 10. Allocation of payments among issues. University L, a political subdivision, issued three separate series of revenue bonds during 1989, 1991, and 1993 under the same bond resolution. L used the proceeds to construct facilities exclusively for its own use. Bonds issued under the resolution are equally and ratably secured and payable solely from the income derived by L from rates, fees, and charges imposed by L for the use of the facilities. The bonds issued in 1989, 1991, and 1993 are not private activity bonds. In 1997, L issues another series of bonds under the resolution to finance additional facilities. L leases 20 percent of the new facilities for the term of the 1997 bonds to nongovernmental persons who will use the facilities in their trades or businesses. The present value of the lease payments from the nongovernmental users will equal 15 percent of the present value of the debt service on the 1997 bonds. L will commingle all of the revenues from all its bond-financed facilities in its revenue fund. The present value of the portion of the lease payments from nongovernmental lessees of the new facilities allocable to the 1997 bonds under paragraph (d) of this section is less than 10 percent of the present value of the debt service on the 1997 bonds because the bond documents provide that the bonds are equally and ratably secured. Accordingly, the 1997 bonds do not meet the private security test. The 1997 bonds meet the private payment test, however, because the private lease payments for the new facility are properly allocated to those bonds (that is, because none of the proceeds of the prior issues were used for the new facilities). See paragraph (c) of this section.

Example 11. Generally applicable tax. (i) Authority N issues bonds to finance the construction of a stadium. Under a long-term lease, Corporation X, a professional sports team, will use more than 10 percent of the stadium. X will not, however, make any payments for this private business use. The security for the bonds will be a ticket tax imposed on each person purchasing a ticket for an event at the stadium. The portion of the ticket tax attributable to tickets purchased by persons attending X's events will, on a present value basis, exceed 10 percent of the present value of the debt service on N's bonds. The bonds meet the private security or payment test. The ticket tax is not a generally applicable tax and, to the extent that the tax receipts relate to X's events, the taxes are payments in respect of property used for a private business use.

(ii) The facts are the same as *Example 11(i)*, except that the ticket tax is imposed by N on tickets purchased for events at a number of large entertainment facilities within the N's jurisdiction (for example, other stadiums, arenas, and concert halls), some of which were not financed with tax-exempt bonds. The ticket tax is a generally applicable tax and therefore the revenues from this tax are not payments in respect of property used for a private business use. The receipt of the ticket tax does not cause the bonds to meet the private security or payment test.

§ 1.141-5 Private loan financing test.

(a) *In general.* Bonds of an issue are private activity bonds if more than the lesser of 5 percent or \$5 million of the proceeds of the issue is to be used (directly or indirectly) to make or finance loans to persons other than gov-

ernmental persons. Section 1.141-2(d) applies in determining whether the private loan financing test is met. In determining whether the proceeds of an issue are used to make or finance loans, indirect, as well as direct, use of the proceeds is taken into account.

(b) *Measurement of test.* In determining whether the private loan financing test is met, the amount actually loaned to a nongovernmental person is not discounted to reflect the present value of the loan repayments.

(c) *Definition of private loan—(1) In general.* Any transaction that is generally characterized as a loan for federal income tax purposes is a loan for purposes of this section. In addition, a loan may arise from the direct lending of bond proceeds or may arise from transactions in which indirect benefits that are the economic equivalent of a loan are conveyed. Thus, the determination of whether a loan is made depends on the substance of a transaction rather than its form. For example, a lease or other contractual arrangement (for example, a management contract or an output contract) may in substance constitute a loan if the arrangement transfers tax ownership of the facility to a nongovernmental person. Similarly, an output contract or a management contract with respect to a financed facility generally is not treated as a loan of proceeds unless the agreement in substance shifts significant burdens and benefits of ownership to the nongovernmental purchaser or manager of the facility.

(2) *Application only to purpose investments—(i) In general.* A loan may be either a purpose investment or a nonpurpose investment. A loan that is a nonpurpose investment does not cause the private loan financing test to be met. For example, proceeds invested in loans, such as obligations of the United States, during a temporary period, as part of a reasonably required reserve or replacement fund, as part of a refunding escrow, or as part of a minor portion (as each of those terms are defined in § 1.148-1 or § 1.148-2) are generally not treated as loans under the private loan financing test.

(ii) *Certain prepayments treated as loans.* Except as otherwise provided, a prepayment for property or services is treated as a loan for purposes of the private loan financing test if a principal purpose for prepaying is to provide a benefit of tax-exempt financing to the

seller. A prepayment is not treated as a loan for purposes of the private loan financing test if—

(A) The prepayment is made for a substantial business purpose other than providing a benefit of tax-exempt financing to the seller and the issuer has no commercially reasonable alternative to the prepayment; or

(B) Prepayments on substantially the same terms are made by a substantial percentage of persons who are similarly situated to the issuer but who are not beneficiaries of tax-exempt financing.

(3) *Grants*—(i) *In general*. A grant of proceeds is not a loan. Whether a transaction may be treated as a grant or a loan depends on all of the facts and circumstances.

(ii) *Tax increment financing*—(A) *In general*. Generally, a grant using proceeds of an issue that is secured by generally applicable taxes attributable to the improvements to be made with the grant is not treated as a loan, unless the grantee makes any impermissible agreements relating to the payment that results in the taxes imposed on that taxpayer not to be treated as generally applicable taxes under § 1.141-4(e).

(B) *Amount of loan*. If a grant is treated as a loan under this paragraph (c)(3), the entire grant is treated as a loan unless the impermissible agreement is limited to a specific portion of the tax. For this purpose, an arrangement with each unrelated grantee is treated as a separate grant.

(4) *Hazardous waste remediation bonds*. In the case of an issue of hazardous waste remediation bonds, payments from nongovernmental persons that are either users of the site being remediated or persons potentially responsible for disposing of hazardous waste on that site do not establish that the transaction is a loan for purposes of this section. This paragraph (c)(4) applies only if those payments do not secure the payment of principal of, or interest on, the bonds (directly or indirectly), under the terms of the bonds and those payments are not taken into account under the private payment test pursuant to § 1.141-4(f)(3).

(d) *Tax assessment loan exception*—(1) *General rule*. For purposes of this section, a tax assessment loan that satisfies the requirements of this paragraph (d) is not a loan for purposes of the private loan financing test.

(2) *Tax assessment loan defined*. A tax assessment loan is a loan that arises when a governmental person permits or

requires property owners to finance any governmental tax or assessment of general application for an essential governmental function that satisfies each of the requirements of paragraphs (d)(3) through (5) of this section.

(3) *Mandatory tax or other assessment*. The tax or assessment must be an enforced contribution that is imposed and collected for the purpose of raising revenue to be used for a specific purpose (that is, to defray the capital cost of an improvement). Taxes and assessments do not include fees for services. The tax or assessment must be imposed pursuant to a state law of general application that can be applied equally to natural persons not acting in a trade or business and persons acting in a trade or business. For this purpose, taxes and assessments that are imposed subject to protest procedures are treated as enforced contributions.

(4) *Specific essential governmental function*—(i) *In general*. A mandatory tax or assessment that gives rise to a tax assessment loan must be imposed for one or more specific, essential governmental functions.

(ii) *Essential governmental functions*. For purposes of paragraph (d) of this section, improvements to utilities and systems that are owned by a governmental person and that are available for use by the general public (such as sidewalks, streets and street-lights; electric, telephone, and cable television systems; sewage treatment and disposal systems; and municipal water facilities) serve essential governmental functions. For other types of facilities, the extent to which the service provided by the facility is customarily performed (and financed with governmental bonds) by governments with general taxing powers is a primary factor in determining whether the facility serves an essential governmental function. For example, parks that are owned by a governmental person and that are available for use by the general public serve an essential governmental function. Except as otherwise provided in this paragraph (d)(4)(ii), commercial or industrial facilities and improvements to property owned by a nongovernmental person do not serve an essential governmental function. Permitting installment payments of property taxes or other taxes is not an essential governmental function.

(5) *Equal basis requirement*—(i) *In general*. Owners of both business and nonbusiness property benefiting from the financed improvements must be eli-

gible, or required, to make deferred payments of the tax or assessment giving rise to a tax assessment loan on an equal basis (the equal basis requirement). A tax or assessment does not satisfy the equal basis requirement if the terms for payment of the tax or assessment are not the same for all taxed or assessed persons. For example, the equal basis requirement is not met if certain property owners are permitted to pay the tax or assessment over a period of years while others must pay the entire tax or assessment immediately or if only certain property owners are required to prepay the tax or assessment when the property is sold.

(ii) *General rule for guarantees*. A guarantee of debt service on bonds, or of taxes or assessments, by a person that is treated as a borrower of bond proceeds violates the equal basis requirement if it is reasonable to expect on the date the guarantee is entered into that payments will be made under the guarantee.

(6) *Coordination with private business tests*. See §§ 1.141-3 and 1.141-4 for rules for determining whether tax assessment loans cause the bonds financing those loans to be private activity bonds under the private business use and the private security or payment tests.

(e) *Examples*. The following examples illustrate the application of this section:

Example 1. Turnkey contract not treated as a loan. State agency Z and federal agency H will each contribute to rehabilitate a project owned by Z. H can only provide its funds through a contribution to Z to be used to acquire the rehabilitated project on a turnkey basis from an approved developer. Under H's turnkey program, the developer must own the project while it is rehabilitated. Z issues its notes to provide funds for construction. A portion of the notes will be retired using the H contribution, and the balance of the notes will be retired through the issuance by Z of long-term bonds. Z lends the proceeds of its notes to Developer B as construction financing and transfers title to B for a nominal amount. The conveyance is made on condition that B rehabilitate the property and reconvey it upon completion, with Z retaining the right to force reconveyance if these conditions are not satisfied. B must name Z as an additional insured on all insurance. Upon completion, B must transfer title to the project back to Z at a set price, which price reflects B's costs and profit, not fair market value. Further, this price is adjusted downward to reflect any cost-underruns. For purposes of section 141(c), this transaction does not involve a private loan.

Example 2. Essential government function requirement not met. City D creates a special taxing district consisting of property owned by nongovernmental persons that requires environmental clean-up. D imposes a special tax on each parcel within the district in an amount that is related to the expected environmental clean-up costs of that

parcel. The payment of the tax over a 20-year period is treated as a loan by the property owners for purposes of the private loan financing test. The special district issues bonds, acting on behalf of D, that are payable from the special tax levied within the district, and uses the proceeds to pay for the costs of environmental clean-up on the property within the district. The bonds meet the private loan financing test because more than 5 percent of the proceeds of the issue are loaned to nongovernmental persons. The issue does not meet the tax assessment loan exception because the improvements to property owned by a nongovernmental person are not an essential governmental function under section 141(c)(2). The issue also meets the private business tests of section 141(b).

§ 1.141-6 Allocation and accounting rules.

(a) *Allocation of proceeds to expenditures.* For purposes of §§ 1.141-1 through 1.141-15, the provisions of § 1.148-6(d) apply for purposes of allocating proceeds to expenditures. Thus, allocations generally may be made using any reasonable, consistently applied accounting method, and allocations under section 141 and section 148 must be consistent with each other.

(b) *Allocation of proceeds to property.* [Reserved]

(c) *Special rules for mixed use facilities.* [Reserved]

(d) *Allocation of proceeds to common areas.* [Reserved]

(e) *Allocation of proceeds to bonds.* [Reserved]

(f) *Treatment of partnerships.* [Reserved]

(g) *Examples.* [Reserved]

§ 1.141-7 Special rules for output contracts.

[Reserved]

§ 1.141-8 \$15 million limitation for output facilities.

[Reserved]

§ 1.141-9 Unrelated or disproportionate use test.

(a) *General rules—(1) Description of test.* Under section 141(b)(3) (the unrelated or disproportionate use test), an issue meets the private business tests if the amount of private business use and private security or payments attributable to unrelated or disproportionate private business use exceeds 5 percent of the proceeds of the issue. For this purpose, the private business use test is applied by taking into account only use that is not related to any government use of proceeds of the issue (unrelated use) and use that is related but disproportionate

to any government use of those proceeds (disproportionate use).

(2) *Application of unrelated or disproportionate use test—(i) Order of application.* The unrelated or disproportionate use test is applied by first determining whether a private business use is related to a government use. Next, private business use that relates to a government use is examined to determine whether it is disproportionate to that government use.

(ii) *Aggregation of unrelated and disproportionate use.* All the unrelated use and disproportionate use financed with the proceeds of an issue are aggregated to determine compliance with the unrelated or disproportionate use test. The amount of permissible unrelated and disproportionate private business use is not reduced by the amount of private business use financed with the proceeds of an issue that is neither unrelated use nor disproportionate use.

(iii) *Deliberate actions.* A deliberate action that occurs after the issue date does not result in unrelated or disproportionate use if the issue meets the conditions of § 1.141-12(a).

(b) *Unrelated use—(1) In general.* Whether a private business use is related to a government use financed with the proceeds of an issue is determined on a case-by-case basis, emphasizing the operational relationship between the government use and the private business use. In general, a facility that is used for a related private business use must be located within, or adjacent to, the governmentally used facility.

(2) *Use for the same purpose as government use.* Use of a facility by a nongovernmental person for the same purpose as use by a governmental person is not treated as unrelated use if the government use is not insignificant. Similarly, a use of a facility in the same manner both for private business use that is related use and private business use that is unrelated use does not result in unrelated use if the related use is not insignificant. For example, a privately owned pharmacy in a governmentally owned hospital does not ordinarily result in unrelated use solely because the pharmacy also serves individuals not using the hospital. In addition, use of parking spaces in a garage by a nongovernmental person is not treated as unrelated use if more than an insignificant portion of the parking spaces are used for a government use (or a private business use that is related to a government use),

even though the use by the nongovernmental person is not directly related to that other use.

(c) *Disproportionate use—(1) Definition of disproportionate use.* A private business use is disproportionate to a related government use only to the extent that the amount of proceeds used for that private business use exceeds the amount of proceeds used for the related government use. For example, a private use of \$100 of proceeds that is related to a government use of \$70 of proceeds results in \$30 of disproportionate use.

(2) *Aggregation of related uses.* If two or more private business uses of the proceeds of an issue relate to a single government use of those proceeds, those private business uses are aggregated to apply the disproportionate use test.

(3) *Allocation rule.* If a private business use relates to more than a single use of the proceeds of the issue (for example, two or more government uses of the proceeds of the issue or a government use and a private use), the amount of any disproportionate use may be determined by—

(i) Reasonably allocating the proceeds used for the private business use among the related uses;

(ii) Aggregating government uses that are directly related to each other; or

(iii) Allocating the private business use to the government use to which it is primarily related.

(d) *Maximum use taken into account.* The determination of the amount of unrelated use or disproportionate use of a facility is based on the maximum amount of reasonably expected government use of a facility during the measurement period. Thus, no unrelated use or disproportionate use arises solely because a facility initially has excess capacity that is to be used by a nongovernmental person if the facility will be completely used by the issuer during the term of the issue for more than an insignificant period.

(e) *Examples.* The following examples illustrate the application of this section:

Example 1. School and remote cafeteria. County X issues bonds with proceeds of \$20 million and uses \$18.1 million of the proceeds for construction of a new school building and \$1.9 million of the proceeds for construction of a privately operated cafeteria in its administrative office building, which is located at a remote site. The bonds are secured, in part, by the cafeteria. The \$1.9 million of proceeds is unrelated to the government use (that is, school construction) financed with the bonds and exceeds 5 percent of \$20 million. Thus, the issue meets the private business tests.

Example 2. Public safety building and courthouse. City Y issues bonds with proceeds of \$50 million for construction of a new public safety building (\$32 million) and for improvements to an existing courthouse (\$15 million). Y uses \$3 million of the bond proceeds for renovations to an existing privately operated cafeteria located in the courthouse. The bonds are secured, in part, by the cafeteria. Y's use of the \$3 million for the privately operated cafeteria does not meet the unrelated or disproportionate use test because these expenditures are neither unrelated use nor disproportionate use.

Example 3. Unrelated garage. City Y issues bonds with proceeds of \$50 million for construction of a new public safety building (\$30.5 million) and for improvements to an existing courthouse (\$15 million). Y uses \$3 million of the bond proceeds for renovations to an existing privately operated cafeteria located in the courthouse. The bonds are secured, in part, by the cafeteria. Y also uses \$1.5 million of the proceeds to construct a privately operated parking garage adjacent to a private office building. The private business use of the parking garage is unrelated to any government use of proceeds of the issue. Since the proceeds used for unrelated uses and disproportionate uses do not exceed 5 percent of the proceeds, the unrelated or disproportionate use test is not met.

Example 4. Disproportionate use of garage. County Z issues bonds with proceeds of \$20 million for construction of a hospital with no private business use (\$17 million); renovation of an office building with no private business use (\$1 million); and construction of a garage that is entirely used for a private business use (\$2 million). The use of the garage is related to the use of the office building but not to the use of the hospital. The private business use of the garage results in \$1 million of disproportionate use because the proceeds used for the garage (\$2 million) exceed the proceeds used for the related government use (\$1 million). The bonds are not private activity bonds, however, because the disproportionate use does not exceed 5 percent of the proceeds of the issue.

Example 5. Bonds for multiple projects. (i) County W issues bonds with proceeds of \$80 million for the following purposes: (1) \$72 million to construct a County-owned and operated waste incinerator; (2) \$1 million for a County-owned and operated facility for the temporary storage of hazardous waste prior to final disposal; (3) \$1 million to construct a privately owned recycling facility located at a remote site; and (4) \$6 million to build a garage adjacent to the County-owned incinerator that will be leased to Company T to store and repair trucks that it owns and uses to haul County W refuse. Company T uses 75 percent of its trucks to haul materials to the incinerator and the remaining 25 percent of its trucks to haul materials to the temporary storage facility.

(ii) The \$1 million of proceeds used for the recycling facility is used for an unrelated use. The garage is related use. In addition, 75 percent of the use of the \$6 million of proceeds used for the garage is allocable to the government use of proceeds at the incinerator. The remaining 25 percent of the proceeds used for the garage (\$1.5 million) relates to the government use of proceeds at the temporary storage facility. Thus, this portion of the proceeds used for the garage exceeds the proceeds used for the temporary storage facility by \$0.5 million and this excess is disproportionate use (but not unrelated use). Thus, the aggregate amount of unrelated use and disproportionate use

financed with the proceeds of the issue is \$1.5 million. Alternatively, under paragraph (c)(3)(iii) of this section, the entire garage may be treated as related to the government use of the incinerator and, under that allocation, the garage is not disproportionate use. In either event, section 141(b)(3) limits the aggregate unrelated use and disproportionate use to \$4 million. Therefore, the bonds are not private activity bonds under this section.

§ 1.141–10 Coordination with volume cap.

[Reserved]

§ 1.141–11 Acquisition of nongovernmental output property.

[Reserved]

§ 1.141–12 Remedial actions.

(a) *Conditions to taking remedial action.* An action that causes an issue to meet the private business tests or the private loan financing test is not treated as a deliberate action if the issuer takes a remedial action described in paragraph (d), (e), or (f) of this section with respect to the nonqualified bonds and if all of the requirements in paragraphs (a)(1) through (5) of this section are met.

(1) *Reasonable expectations test met.* The issuer reasonably expected on the issue date that the issue would meet neither the private business tests nor the private loan financing test for the entire term of the bonds. For this purpose, if the issuer reasonably expected on the issue date to take a deliberate action prior to the final maturity date of the issue that would cause either the private business tests or the private loan financing test to be met, the term of the bonds for this purpose may be determined by taking into account a redemption provision if the provisions of § 1.141–2(d)(2)(ii)(A) through (C) are met.

(2) *Maturity not unreasonably long.* The term of the issue must not be longer than is reasonably necessary for the governmental purposes of the issue (within the meaning of § 1.148–1(c)(4)). Thus, this requirement is met if the weighted average maturity of the bonds of the issue is not greater than 120 percent of the average reasonably expected economic life of the property financed with the proceeds of the issue as of the issue date.

(3) *Fair market value consideration.* Except as provided in paragraph (f) of this section, the terms of any arrangement that results in satisfaction of either the private business tests or the private

loan financing test are bona fide and arm's-length, and the new user pays fair market value for the use of the financed property. Thus, for example, fair market value may be determined in a manner that takes into account restrictions on the use of the financed property that serve a bona fide governmental purpose.

(4) *Disposition proceeds treated as gross proceeds for arbitrage purposes.* The issuer must treat any disposition proceeds as gross proceeds for purposes of section 148. For purposes of eligibility for temporary periods under section 148(c) and exemptions from the requirement of section 148(f) the issuer may treat the date of receipt of the disposition proceeds as the issue date of the bonds and disregard the receipt of disposition proceeds for exemptions based on expenditure of proceeds under § 1.148–7 that were met before the receipt of the disposition proceeds.

(5) *Proceeds expended on a governmental purpose.* Except for a remedial action under paragraph (d) of this section, the proceeds of the issue that are affected by the deliberate action must have been expended on a governmental purpose before the date of the deliberate action.

(b) *Effect of a remedial action—(1) In general.* The effect of a remedial action is to cure use of proceeds that causes the private business use test or the private loan financing test to be met. A remedial action does not affect application of the private security or payment test.

(2) *Effect on bonds that have been advance refunded.* If proceeds of an issue were used to advance refund another bond, a remedial action taken with respect to the refunding bond proportionately reduces the amount of proceeds of the advance refunded bond that is taken into account under the private business use test or the private loan financing test.

(c) *Disposition proceeds—(1) Definition.* *Disposition proceeds* are any amounts (including property, such as an agreement to provide services) derived from the sale, exchange, or other disposition (disposition) of property (other than investments) financed with the proceeds of an issue.

(2) *Allocating disposition proceeds to an issue.* In general, if the requirements of paragraph (a) of this section are met, after the date of the disposition, the proceeds of the issue allocable to the transferred property are treated as financing the disposition proceeds rather

than the transferred property. If a disposition is made pursuant to an installment sale, the proceeds of the issue continue to be allocated to the transferred property. If an issue does not meet the requirements for remedial action in paragraph (a) of this section or the issuer does not take an appropriate remedial action, the proceeds of the issue are allocable to either the transferred property or the disposition proceeds, whichever allocation produces the greater amount of private business use and private security or payments.

(3) *Allocating disposition proceeds to different sources of funding.* If property has been financed by different sources of funding, for purposes of this section, the disposition proceeds from that property are first allocated to the outstanding bonds that financed that property in proportion to the principal amounts of those outstanding bonds. In no event may disposition proceeds be allocated to bonds that are no longer outstanding or to a source of funding not derived from a borrowing (such as revenues of the issuer) if the disposition proceeds are not greater than the total principal amounts of the outstanding bonds that are allocable to that property. For purposes of this paragraph (c)(3), principal amount has the same meaning as in § 1.148-9(b)(2) and outstanding bonds do not include advance refunded bonds.

(d) *Redemption or defeasance of nonqualified bonds—(1) In general.* The requirements of this paragraph (d) are met if all of the nonqualified bonds of the issue are redeemed. Proceeds of tax-exempt bonds must not be used for this purpose, unless the tax-exempt bonds are qualified bonds, taking into account the purchaser's use of the facility. If the bonds are not redeemed within 90 days of the date of the deliberate action, a defeasance escrow must be established for those bonds within 90 days of the deliberate action.

(2) *Special rule for dispositions for cash.* If the consideration for the disposition of financed property is exclusively cash, the requirements of this paragraph (d) are met if the disposition proceeds are used to redeem a pro rata portion of the nonqualified bonds at the earliest call date after the deliberate action. If the bonds are not redeemed within 90 days of the date of the deliberate action, the disposition proceeds must be used to establish a defeasance escrow for those bonds within 90 days of the deliberate action.

(3) *Notice of defeasance.* The issuer must provide written notice to the Commissioner of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

(4) *Special limitation.* The establishment of a defeasance escrow does not satisfy the requirements of this paragraph (d) if the period between the issue date and the first call date of the bonds is more than 10 1/2 years.

(5) *Defeasance escrow defined.* A defeasance escrow is an irrevocable escrow established to redeem bonds on their earliest call date in an amount that, together with investment earnings, is sufficient to pay all the principal of, and interest and call premium on, bonds from the date the escrow is established to the earliest call date. The escrow may not be invested in higher yielding investments or in any investment under which the obligor is a user of the proceeds of the bonds.

(e) *Alternative use of disposition proceeds—(1) In general.* The requirements of this paragraph (e) are met if—

(i) The deliberate action is a disposition for which the consideration is exclusively cash;

(ii) The issuer reasonably expects to expend the disposition proceeds within two years of the date of the deliberate action;

(iii) The disposition proceeds are treated as proceeds for purposes of section 141 and are used in a manner that does not cause the issue to meet either the private business tests or the private loan financing test, and the issuer does not take any action subsequent to the date of the deliberate action to cause either of these tests to be met; and

(iv) If the issuer does not use all of the disposition proceeds for an alternative use described in paragraph (e)(1)(iii) of this section, the issuer uses those remaining disposition proceeds for a remedial action that meets paragraph (d) of this section.

(2) *Special rule for use by 501(c)(3) organizations.* If the disposition proceeds are to be used by a 501(c)(3) organization, the nonqualified bonds must in addition be treated as reissued for purposes of sections 141, 145, 147, 149, and 150 and, under this treatment, satisfy all of the applicable requirements for qualified 501(c)(3) bonds. Thus, beginning on the date of the deliberate action, nonqualified bonds that satisfy these requirements must be treated as

qualified 501(c)(3) bonds for all purposes, including sections 145(b) and 150(b).

(f) *Alternative use of facility.* The requirements of this paragraph (f) are met if—

(1) The facility with respect to which the deliberate action occurs is used in an alternative manner (for example, used for a qualifying purpose by a nongovernmental person or used by a 501(c)(3) organization rather than a governmental person);

(2) The nonqualified bonds are treated as reissued, as of the date of the deliberate action, for purposes of sections 55 through 59 and 141, 142, 144, 145, 146, 147, 149 and 150, and under this treatment, the nonqualified bonds satisfy all the applicable requirements for qualified bonds throughout the remaining term of the nonqualified bonds;

(3) The deliberate action does not involve a disposition to a purchaser that finances the acquisition with proceeds of another issue of tax-exempt bonds; and

(4) Any disposition proceeds other than those arising from an agreement to provide services (including disposition proceeds from an installment sale) resulting from the deliberate action are used to pay the debt service on the bonds on the next available payment date or, within 90 days of receipt, are deposited into an escrow that is restricted to the yield on the bonds to pay the debt service on the bonds on the next available payment date.

(g) *Rules for deemed reissuance.* For purposes of determining whether bonds that are treated as reissued under paragraphs (e) and (f) of this section are qualified bonds—

(1) The provisions of the Code and regulations thereunder in effect as of the date of the deliberate action apply; and

(2) For purposes of paragraph (f) of this section, section 147(d) (relating to the acquisition of existing property) does not apply.

(h) *Authority of Commissioner to provide for additional remedial actions.* The Commissioner may, by publication in the Federal Register or the Internal Revenue Bulletin, provide additional remedial actions, including making a remedial payment to the United States, under which a subsequent action will not be treated as a deliberate action for purposes of § 1.141-2.

(i) *Effect of remedial action on continuing compliance.* Solely for purposes of determining whether deliberate actions that are taken after a remedial

action cause an issue to meet the private business tests or the private loan financing test—

(1) If a remedial action is taken under paragraph (d), (e), or (f) of this section, the private business use or private loans resulting from the deliberate action are not taken into account for purposes of determining whether the bonds are private activity bonds; and

(2) After a remedial action is taken, the amount of disposition proceeds is treated as equal to the proceeds of the issue that had been allocable to the transferred property immediately prior to the disposition. See paragraph (k) of this section, *Example 5*.

(j) *Nonqualified bonds*—(1) *Amount of nonqualified bonds*. The percentage of outstanding bonds that are nonqualified bonds equals the highest percentage of private business use in any 1-year period commencing with the deliberate action.

(2) *Allocation of nonqualified bonds*. Allocations to nonqualified bonds must be made on a pro rata basis, except that, for purposes of paragraph (d) of this section (relating to redemption or defeasance), an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds.

(k) *Examples*. The following examples illustrate the application of this section:

Example 1. Disposition proceeds less than outstanding bonds used to retire bonds. On June 1, 1997, City C issues 30-year bonds with an issue price of \$10 million to finance the construction of a hospital building. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the building. On the issue date, C reasonably expects that it will be the only user of the building for the entire term of the bonds. Six years after the issue date, C sells the building to Corporation P for \$5 million. The sale price is the fair market value of the building, as verified by an independent appraiser. C uses all of the \$5 million disposition proceeds to immediately retire a pro rata portion of the bonds. The sale does not cause the bonds to be private activity bonds because C has taken a remedial action described in paragraph (d) of this section so that P is not treated as a private business user of bond proceeds.

Example 2. Lease to nongovernmental person. The facts are the same as in *Example 1*, except that instead of selling the building, C, 6 years after the issue date, leases the building to P for 7 years and uses other funds to redeem all of the \$10 million outstanding bonds within 90 days of the deliberate act. The bonds are not treated as private activity bonds because C has taken the remedial action described in paragraph (d) of this section.

Example 3. Sale for less than fair market value. The facts are the same as in *Example 1*, except that the fair market value of the building at the time of the sale to P is \$6 million. Because the transfer was for less than fair market value, the

bonds are ineligible for the remedial actions under this section. The bonds are private activity bonds because P is treated as a user of all of the proceeds and P makes a payment (\$6 million) for this use that is greater than 10 percent of the debt service on the bonds, on a present value basis.

Example 4. Fair market value determined taking into account governmental restrictions. The facts are the same as in *Example 1*, except that the building was used by C only for hospital purposes and C determines to sell the building subject to a restriction that it be used only for hospital purposes. After conducting a public bidding procedure as required by state law, the best price that C is able to obtain for the building subject to this restriction is \$4.5 million from P. C uses all of the \$4.5 million disposition proceeds to immediately retire a pro rata portion of the bonds. The sale does not cause the bonds to be private activity bonds because C has taken a remedial action described in paragraph (d) of this section so that P is not treated as a private business user of bond proceeds.

Example 5. Alternative use of disposition proceeds. The facts are the same as in *Example 1*, except that C reasonably expects on the date of the deliberate action to use the \$5 million disposition proceeds for another governmental purpose (construction of governmentally owned roads) within two years of receipt, rather than using the \$5 million to redeem outstanding bonds. C treats these disposition proceeds as gross proceeds for purposes of section 148. The bonds are not private activity bonds because C has taken a remedial action described in paragraph (e) of this section. After the date of the deliberate action, the proceeds of all of the outstanding bonds are treated as used for the construction of the roads, even though only \$5 million of disposition proceeds was actually used for the roads.

Example 6. Alternative use of financed property. The facts are the same as in *Example 1*, except that C determines to lease the hospital building to Q, an organization described in section 501(c)(3), for a term of 10 years rather than to sell the building to P. In order to induce Q to provide hospital services, C agrees to lease payments that are less than fair market value. Before entering into the lease, an applicable elected representative of C approves the lease after a noticed public hearing. As of the date of the deliberate action, the issue meets all the requirements for qualified 501(c)(3) bonds, treating the bonds as reissued on that date. For example, the issue meets the two percent restriction on use of proceeds of finance issuance costs of section 147(g) because the issue pays no costs of issuance from disposition proceeds in connection with the deemed reissuance. C and Q treat the bonds as qualified 501(c)(3) bonds for all purposes commencing with the date of the deliberate action. The bonds are treated as qualified 501(c)(3) bonds commencing with the date of the deliberate action.

Example 7. Deliberate action before proceeds are expended on a governmental purpose. County J issues bonds with proceeds of \$10 million that can be used only to finance a correctional facility. On the issue date of the bonds, J reasonably expects that it will be the sole user of the bonds for the useful life of the facility. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the facility. After the issue date of the bonds, but before the facility is placed in service, J enters into a contract with the federal government pursuant to which the federal government will make a fair market value, lump sum payment equal to 25 percent of the cost of the facility. In

exchange for this payment, J provides the federal government with priority rights to use of 25 percent of the facility. J uses the payment received from the federal government to defease the nonqualified bonds. The agreement does not cause the bonds to be private activity bonds because J has taken a remedial action described in paragraph (d) of this section. See paragraph (a)(5) of this section.

Example 8. Compliance after remedial action. In 1997, City G issues bonds with proceeds of \$10 million to finance a courthouse. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the courthouse. G uses \$1 million of the proceeds for a private business use and more than 10 percent of the debt service on the issue is secured by private security or payments. G later sells one-half of the courthouse property to a nongovernmental person for cash. G immediately redeems 60 percent of the outstanding bonds. This percentage of outstanding bonds is based on the highest private business use of the courthouse in any 1-year period commencing with the deliberate action. For purposes of subsequently applying section 141 to the issue, G may continue to use all of the proceeds of the outstanding bonds in the same manner (that is, for both the courthouse and the existing private business use) without causing the issue to meet the private business use test. The issue, however, continues to meet the private security or payment test. The result would be the same if D, instead of redeeming the bonds, established a defeasance escrow for those bonds, provided that the requirement of paragraph (d)(4) of this section was met.

§ 1.141–13 Refunding issues.

[Reserved]

§ 1.141–14 Anti-abuse rules.

(a) *Authority of Commissioner to reflect substance of transactions*. If an issuer enters into a transaction or series of transactions with respect to one or more issues with a principal purpose of transferring to nongovernmental persons (other than as members of the general public) significant benefits of tax-exempt financing in a manner that is inconsistent with the purposes of section 141, the Commissioner may take any action to reflect the substance of the transaction or series of transactions, including—

(1) Treating separate issues as a single issue for purposes of the private activity bond tests;

(2) Reallocating proceeds to expenditures, property, use, or bonds;

(3) Reallocating payments to use or proceeds;

(4) Measuring private business use on a basis that reasonably reflects the economic benefit in a manner different than as provided in § 1.141–3(g); and

(5) Measuring private payments or security on a basis that reasonably re-

flects the economic substance in a manner different than as provided in § 1.141-4.

(b) *Examples.* The following examples illustrate the application of this section:

Example 1. Reallocating proceeds to indirect use. City C issues bonds with proceeds of \$20 million for the stated purpose of financing improvements to roads that it owns. As a part of the same plan of financing, however, C also agrees to make a loan of \$7 million to Corporation M from its general revenues that it otherwise would have used for the road improvements. The interest rate of the loan corresponds to the interest rate on a portion of the issue. A principal purpose of the financing arrangement is to transfer to M significant benefits of the tax-exempt financing. Although C actually allocates all of the proceeds of the bonds to the road improvements, the Commissioner may reallocate a portion of the proceeds of the bonds to the loan to M because a principal purpose of the financing arrangement is to transfer to M significant benefits of tax-exempt financing in a manner that is inconsistent with the purposes of section 141. The bonds are private activity bonds because the issue meets the private loan financing test. The bonds also meet the private business tests. See also §§ 1.141-3(a)(2), 1.141-4(a)(1), and 1.141-5(a), under which indirect use of proceeds and payments are taken into account.

Example 2. Taking into account use of amounts derived from proceeds that would be otherwise disregarded. County B issues bonds with proceeds of \$10 million to finance the purchase of land. On the issue date, B reasonably expects that it will be the sole user of the land. Subsequently, the federal government acquires the land for \$3 million in a condemnation action. B uses this amount to make a loan to Corporation M. In addition, the interest rate on the loan reflects the tax-exempt interest rate on the bonds and thus is substantially less than a current market rate. A principal purpose of the arrangement is to transfer to M significant benefits of the tax-exempt financing. Although the condemnation action is not a deliberate action, the Commissioner may treat the condemnation proceeds as proceeds of the issue because a principal purpose of the arrangement is to transfer to M significant benefits of tax-exempt financing in a manner inconsistent with the purposes of section 141. The bonds are private activity bonds.

Example 3. Measuring private business use on an alternative basis. City F issues bonds with a 30-year term to finance the acquisition of an industrial building having a remaining reasonably expected useful economic life of more than 30 years. On the issue date, F leases the building to Corporation G for 3 years. F reasonably expects that it will be the sole user of the building for the remaining term of the bonds. Because of the local market conditions, it is reasonably expected that the fair rental value of the industrial building will be significantly greater during the early years of the term of the bonds than in the later years. The annual rental payments are significantly less than fair market value, reflecting the interest rate on the bonds. The present value of these rental payments (net of operation and maintenance expenses) as of the issue date, however, is approximately 25 percent of the present value of debt service on the issue. Under § 1.141-3, the issue does not meet the private business tests, because only 10 percent of the proceeds are used in a trade or business by a nongovernmental person. A principal purpose of the issue is to transfer to G significant benefits of

tax-exempt financing in a manner inconsistent with the purposes of section 141. The method of measuring private business use over the reasonably expected useful economic life of financed property is for the administrative convenience of issuers of state and local bonds. In cases where this method is used in a manner inconsistent with the purposes of section 141, the Commissioner may measure private business use on another basis that reasonably reflects economic benefit, such as in this case on an annual basis. If the Commissioner measures private business use on an annual basis, the bonds are private activity bonds because the private payment test is met and more than 10 percent of the proceeds are used in a trade or business by a nongovernmental person.

Example 4. Treating separate issues as a single issue. City D enters into a development agreement with Corporation T to induce T to locate its headquarters within D's city limits. Pursuant to the development agreement, in 1997 D will issue \$20 million of its general obligation bonds (the 1997 bonds) to purchase land that it will grant to T. The development agreement also provides that, in 1998, D will issue \$20 million of its tax increment bonds (the 1998 bonds), secured solely by the increase in property taxes in a special taxing district. Substantially all of the property within the special taxing district is owned by T or D. T will separately enter into an agreement to guarantee the payment of tax increment to D in an amount sufficient to retire the 1998 bonds. The proceeds of the 1998 bonds will be used to finance improvements owned and operated by D that will not give rise to private business use. Treated separately, the 1997 issue meets the private business use test, but not the private security or payment test; the 1998 issue meets the private security or payment test, but not the private business use test. A principal purpose of the financing plan including the two issues is to transfer significant benefits of tax-exempt financing to T for its headquarters. Thus, the 1997 issue and the 1998 issue may be treated by the Commissioner as a single issue for purposes of applying the private activity bond tests. Accordingly, the bonds of both the 1997 issue and the 1998 issue may be treated as private activity bonds.

Example 5. Reallocating proceeds. City E acquires an electric generating facility with a useful economic life of more than 40 years and enters into a 30-year take or pay contract to sell 30 percent of the available output to investor-owned utility M. E plans to use the remaining 70 percent of available output for its own governmental purposes. To finance the entire cost of the facility, E issues \$30 million of its series A taxable bonds at taxable interest rates and \$70 million series B bonds, which purport to be tax-exempt bonds, at tax-exempt interest rates. E allocates all of M's private business use to the proceeds of the series A bonds and all of its own government use to the proceeds of the series B bonds. The series A bonds have a weighted average maturity of 15 years, while the series B bonds have a weighted average maturity of 26 years. M's payments under the take or pay contract are expressly determined by reference to 30 percent of M's total costs (that is, the sum of the debt service required to be paid on both the series A and the series B bonds and all other operating costs). The allocation of all of M's private business use to the series A bonds does not reflect economic substance because the series of transactions transfers to M significant benefits of the tax-exempt interest rates paid on the series B bonds. A principal purpose of the financing arrangement is to transfer to M significant benefits of the tax-exempt financing. Accordingly, the

Commissioner may allocate M's private business use on a pro rata basis to both the series B bonds as well as the series A bonds, in which case the series B bonds are private activity bonds.

Example 6. Allocations respected. The facts are the same as in *Example 5*, except that the debt service component of M's payments under the take or pay contract is based exclusively on the amounts necessary to pay the debt service on the taxable series A bonds. E's allocation of all of M's private business use to the series A bonds is respected because the series of transactions does not actually transfer benefits of tax-exempt interest rates to M. Accordingly, the series B bonds are not private activity bonds. The result would be the same if M's payments under the take or pay contract were based exclusively on fair market value pricing, rather than the tax-exempt interest rates on E's bonds. The result also would be the same if the series A bonds and the series B bonds had substantially equivalent weighted average maturities and E and M had entered into a customary contract providing for payments based on a ratable share of total debt service. E would not be treated by the Commissioner in any of these cases as entering into the contract with a principal purpose of transferring the benefits of tax-exempt financing to M in a manner inconsistent with the purposes of section 141.

§ 1.141-15 Effective dates.

(a) *Scope.* The effective dates in this section apply for purposes of §§ 1.141-0 through 1.141-14, and 1.145-0 through 1.145-2 (the private activity bond regulations), and § 1.150-1(a)(3) and the definition of bond documents contained in § 1.150-1(b).

(b) *Effective dates.* Except as otherwise provided in this section, the private activity bond regulations, § 1.150-1(a)(3), and the definition of bond documents contained in § 1.150-1(b) apply to bonds issued on or after May 16, 1997, (the effective date) that are subject to section 1301 of the Tax Reform Act of 1986.

(c) *Refunding bonds.* The private activity bond regulations, § 1.150-1(a)(3), and the definition of bond documents contained in § 1.150-1(b) do not apply to bonds issued on or after the effective date to refund a bond to which the private activity bond regulations do not apply unless—

(1) The weighted average maturity of the refunding bonds is longer than—

(i) The weighted average maturity of the refunded bonds; or

(ii) In the case of a short-term obligation that the issuer reasonably expects to refund with a long-term financing (such as a bond anticipation note), 120 percent of the weighted average reasonably expected economic life of the facilities financed; or

(2) A principal purpose for the issuance of the refunding bonds is to make one or more new conduit loans.

(d) *Permissive application of regulations.* Except as provided in paragraph (e) of this section, the private activity bond regulations, § 1.150-1(a)(3), and the definition of bond documents contained in § 1.150-1(b) may be applied in whole, but not in part, to—

(1) Bonds that are outstanding on the effective date and subject to section 141; or

(2) Refunding bonds issued on or after the effective date.

(e) *Permissive retroactive application of certain sections.* The following sections may each be applied to any bonds issued before the effective date:

- (1) Section 1.141-3(b)(4);
- (2) Section 1.141-3(b)(6); and
- (3) Section 1.141-12.

§ 1.141-16 Effective dates for qualified private activity bond provisions.

(a) *Scope.* The effective dates of this section apply for purposes of §§ 1.142-0 through 1.142-2, 1.144-0 through 1.144-2, 1.147-0 through 1.147-2, and 1.150-4.

(b) *Effective dates.* Except as otherwise provided in this section, the regulations designated in paragraph (a) of this section apply to bonds issued on or after May 16, 1997, (the effective date).

(c) *Permissive application.* The regulations designated in paragraph (a) of this section may be applied in whole, but not in part, to bonds outstanding on the effective date.

Par. 7. Sections 1.142-0 and 1.142-3 are added and §§ 1.142-1 and 1.142-2 are revised to read as follows:

§ 1.142-0 *Table of Contents.* This section lists the captioned paragraphs contained in §§ 1.142-1 through 1.142-3.

§ 1.142-1 Exempt facility bonds.

- (a) Overview.
- (b) Scope.
- (c) Effective dates.

§ 1.142-2 Remedial actions.

- (a) General rule.
- (b) Reasonable expectations requirement.
- (c) Redemption or defeasance.
 - (1) In general.
 - (2) Notice of defeasance.
 - (3) Special limitation.
 - (4) Special rule for dispositions of personal property.
 - (5) Definitions.
- (d) When a failure to properly use proceeds occurs.

- (1) Proceeds not spent.
- (2) Proceeds spent.
- (e) Nonqualified bonds.

§ 1.142-3 Refunding issues.

[Reserved]

§ 1.142-1 Exempt facility bonds.

(a) *Overview.* Interest on a private activity bond is not excludable from gross income under section 103(a) unless the bond is a qualified bond. Under section 141(e)(1)(A), an exempt facility bond issued under section 142 may be a qualified bond. Under section 142(a), an exempt facility bond is any bond issued as a part of an issue using 95 percent or more of the proceeds for certain exempt facilities.

(b) *Scope.* Sections 1.142-0 through 1.142-3 apply for purposes of the rules for exempt facility bonds under section 142, except that, with respect to net proceeds that have been spent, § 1.142-2 does not apply to bonds issued under section 142(d) (relating to bonds issued to provide qualified residential rental projects) and section 142(f)(2) and (4) (relating to bonds issued to provide local furnishing of electric energy or gas).

(c) *Effective dates.* For effective dates of §§ 1.142-0 through 1.142-2, see § 1.141-16.

§ 1.142-2 Remedial actions.

(a) *General rule.* If less than 95 percent of the net proceeds of an exempt facility bond are actually used to provide an exempt facility, and for no other purpose, the issue will be treated as meeting the use of proceeds requirement of section 142(a) if the issue meets the condition of paragraph (b) of this section and the issuer takes the remedial action described in paragraph (c) of this section.

(b) *Reasonable expectations requirement.* The issuer must have reasonably expected on the issue date that 95 percent of the net proceeds of the issue would be used to provide an exempt facility and for no other purpose for the entire term of the bonds (disregarding any redemption provisions). To meet this condition the amount of the issue must have been based on reasonable estimates about the cost of the facility.

(c) *Redemption or defeasance—(1) In general.* The requirements of this paragraph (c) are met if all of the nonqualified bonds of the issue are redeemed on

the earliest call date after the date on which the failure to properly use the proceeds occurs under paragraph (d) of this section. Proceeds of tax-exempt bonds (other than those described in paragraph (d)(1) of this section) must not be used for this purpose. If the bonds are not redeemed within 90 days of the date on which the failure to properly use proceeds occurs, a defeasance escrow must be established for those bonds within 90 days of that date.

(2) *Notice of defeasance.* The issuer must provide written notice to the Commissioner of the establishment of the defeasance escrow within 90 days of the date the escrow is established.

(3) *Special limitation.* The establishment of a defeasance escrow does not satisfy the requirements of this paragraph (c) if the period between the issue date and the first call date is more than 10 1/2 years.

(4) *Special rule for dispositions of personal property.* For dispositions of personal property exclusively for cash, the requirements of this paragraph (c) are met if the issuer expends the disposition proceeds within 6 months of the date of the disposition to acquire replacement property for the same qualifying purpose of the issue under section 142.

(5) *Definitions.* For purposes of paragraph (c)(4) of this section, *disposition proceeds* means disposition proceeds as defined in § 1.141-12(c).

(d) *When a failure to properly use proceeds occurs—(1) Proceeds not spent.* For net proceeds that are not spent, a failure to properly use proceeds occurs on the earlier of the date on which the issuer reasonably determines that the financed facility will not be completed or the date on which the financed facility is placed in service.

(2) *Proceeds spent.* For net proceeds that are spent, a failure to properly use proceeds occurs on the date on which an action is taken that causes the bonds not to be used for the qualifying purpose for which the bonds were issued.

(e) *Nonqualified bonds.* For purposes of this section, the nonqualified bonds are a portion of the outstanding bonds in an amount that, if the remaining bonds were issued on the date on which the failure to properly use the proceeds occurs, at least 95 percent of the net proceeds of the remaining bonds would be used to provide an exempt facility. If no proceeds have been spent to provide an exempt facility, all of the outstanding

bonds are nonqualified bonds. The nonqualified bonds must be determined on a pro rata allocation basis, except that an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds.

§ 1.142-3 *Refunding issues.*

[Reserved]

Par. 8. Sections 1.144-0 is added and §§ 1.144-1 and 1.144-2 are revised to read as follows:

§ 1.144-0 *Table of Contents.* This section lists the captioned paragraphs contained in §§ 1.144-1 and 1.144-2.

§ 1.144-1 *Qualified small issue bonds, qualified student loan bonds, and qualified redevelopment bonds.*

- (a) Overview.
- (b) Scope.
- (c) Effective dates.

§ 1.144-2 *Remedial actions.*

§ 1.144-1 *Qualified small issue bonds, qualified student loan bonds, and qualified redevelopment bonds.*

(a) *Overview.* Interest on a private activity bond is not excludable from gross income under section 103(a) unless the bond is a qualified bond. Under section 141(e)(1)(D), a qualified small issue bond issued under section 144(a) may be a qualified bond. Under section 144(a), any qualified small issue bond is any bond issued as a part of an issue 95 percent or more of the proceeds of which are to be used to provide certain manufacturing facilities or certain depreciable farm property and which meets other requirements. Under section 141(e)(1)(F) a qualified redevelopment bond issued under section 144(c) is a qualified bond. Under section 144(c), a qualified redevelopment bond is any bond issued as a part of an issue 95 percent or more of the net proceeds of which are to be used for one or more redevelopment purposes and which meets certain other requirements.

(b) *Scope.* Sections 1.144-0 through 1.144-2 apply for purposes of the rules for small issue bonds under section 144(a) and qualified redevelopment bonds under section 144(c), except that § 1.144-2 does not apply to the requirements for qualified small issue bonds under section 144(a)(4) (relating to the limitation on capital expenditures) or under section 144(a)(10) (relating to the aggregate limit of tax-exempt bonds per taxpayer).

(c) *Effective dates.* For effective dates of §§ 1.144-0 through 1.144-2, see § 1.141-16.

§ 1.144-2 *Remedial actions.* The remedial action rules of § 1.142-2 apply to qualified small issue bonds issued under section 144(a) and to qualified redevelopment bonds issued under section 144(c), for this purpose treating those bonds as exempt facility bonds and the qualifying purposes for those bonds as exempt facilities.

Par. 9. Sections 1.145-0 through 1.145-2 are added to read as follows:

§ 1.145-0 *Table of Contents.* This section lists the captioned paragraphs contained in §§ 1.145-1 and 1.145-2.

§ 1.145-1 *Qualified 501(c)(3) bonds.*

- (a) Overview.
- (b) Scope.
- (c) Effective dates.

§ 1.145-2 *Application of private activity bond regulations.*

- (a) In general.
- (b) Modification of private business tests.
- (c) Exceptions.
 - (1) Certain provisions relating to governmental programs.
 - (2) Costs of issuance.

§ 1.145-1 *Qualified 501(c)(3) bonds.*

(a) *Overview.* Interest on a private activity bond is not excludable from gross income under section 103(a) unless the bond is a qualified bond. Under section 141(e)(1)(G), a qualified 501(c)(3) bond issued under section 145 is a qualified bond. Under section 145, a qualified 501(c)(3) bond is any bond issued as a part of an issue that satisfies the requirements of sections 145(a) through (d).

(b) *Scope.* Sections 1.145-0 through 1.145-2 apply for purposes of section 145(a).

(c) *Effective dates.* For effective dates of §§ 1.145-0 through 1.145-2, see § 1.141-15.

§ 1.145-2 *Application of private activity bond regulations.*

(a) *In general.* Except as provided in this section, §§ 1.141-0 through 1.141-15 apply to section 145(a). For example, under this section, § 1.141-1, and § 1.141-2, an issue ceases to be an issue of qualified 501(c)(3) bonds if the

issuer or a conduit borrower 501(c)(3) organization takes a deliberate action, subsequent to the issue date, that causes the issue to fail to comply with the requirements of sections 141(e) and 145 (such as an action that results in revocation of exempt status of the 501(c)(3) organization).

(b) *Modification of private business tests.* In applying §§ 1.141-0 through 1.141-15 to section 145(a)—

(1) References to governmental persons include 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under section 513(a);

(2) References to “10 percent” and “proceeds” in the context of the private business use test and the private security or payment test mean “5 percent” and “net proceeds”; and

(3) References to the private business use test in §§ 1.141-2 and 1.141-12 include the ownership test of section 145(a)(1).

(c) *Exceptions—(1) Certain provisions relating to governmental programs.* The following provisions do not apply to section 145: § 1.141-2(d)(4) (relating to the special rule for dispositions of personal property in the ordinary course of an established governmental program) and § 1.141-2(d)(5) (relating to the special rule for general obligation bond programs that finance a large number of separate purposes).

(2) *Costs of issuance.* Section 1.141-3(g)(6) does not apply to section 145(a)(2) to the extent that it provides that costs of issuance are allocated ratably among the other purposes for which the proceeds are used. For purposes of section 145(a)(2), costs of issuance are treated as private business use.

Par. 10. Sections 1.147-0 through 1.147-2 are added to read as follows:

§ 1.147-0 *Table of Contents.* This section lists the captioned paragraphs contained in §§ 1.147-1 and 1.147-2.

§ 1.147-1 *Other requirements applicable to certain private activity bonds.*

- (a) Overview.
- (b) Scope.
- (c) Effective dates.

§ 1.147-2 *Remedial actions.*

§ 1.147-1 *Other requirements applicable to certain private activity bonds.*

(a) *Overview.* Interest on a private activity bond is not excludable from

gross income under section 103(a) unless the bond is a qualified bond. Under section 147, certain requirements must be met for a private activity bond to qualify as a qualified bond.

(b) *Scope.* Sections 1.147-0 through 1.147-2 apply for purposes of the rules in section 147 for qualified private activity bonds that permit use of proceeds to acquire land for environmental purposes (section 147(c)(3)), permit use of proceeds for certain rehabilitations (section 147(d)(2) and (3)), prohibit use of proceeds to finance skyboxes, airplanes, gambling establishments and similar facilities (section 147(e)), and require public approval (section 147(f)), but not for the rules limiting use of proceeds to acquire land or existing property under sections 147(c)(1) and (2), and (d)(1).

(c) *Effective dates.* For effective dates of §§ 1.147-0 through 1.147-2, see § 1.141-16.

§ 1.147-2 Remedial actions.

The remedial action rules of § 1.142-2 apply to the rules in section 147 for qualified private activity bonds that permit use of proceeds to acquire land for environmental purposes (section 147(c)(3)), permit use of proceeds for certain rehabilitations (section 147(d)(2) and (3)), prohibit use of proceeds to finance skyboxes, airplanes, gambling establishments and similar facilities (section 147(e)), and require public approval (section 147(f)), for this purpose treating those private activity bonds subject to the rules under section 147 as exempt facility bonds and the qualifying purposes for those bonds as exempt facilities.

Par. 11. Section 1.148-6 is amended by adding new paragraphs (a)(3) and (d)(1)(iii) to read as follows:

§ 1.148-6 General allocation and accounting rules.

(a) * * *

(3) *Absence of allocation and accounting methods.* If an issuer fails to maintain books and records sufficient to establish the accounting method for an issue and the allocation of the proceeds of that issue, the rules of this section are applied using the specific tracing method. This paragraph (a)(3) applies to bonds issued on or after May 16, 1997.

* * * * *

(d) * * *

(1) * * *

(iii) *Timing.* An issuer must account for the allocation of proceeds to expen-

ditures not later than 18 months after the later of the date the expenditure is paid or the date the project, if any, that is financed by the issue is placed in service. This allocation must be made in any event by the date 60 days after the fifth anniversary of the issue date or the date 60 days after the retirement of the issue, if earlier. This paragraph (d)(1)(iii) applies to bonds issued on or after May 16, 1997.

* * * * *

Par. 12. Section 1.150-1 is amended as follows:

1. Paragraph (a)(3) is added.

2. Paragraph (b) is amended by adding a new definition in alphabetical order.

The additions read as follows:

§ 1.150-1 Definitions.

(a) * * *

(3) *Exception to general effective date.* See § 1.141-15 for the effective date of the definition of bond documents contained in paragraph (b) of this section.

* * * * *

(b) * * *

Bond documents means the bond indenture or resolution, transcript of proceedings, and any related documents.

* * * * *

Par. 13. Section 1.150-4 is added to read as follows:

§ 1.150-4 Change in use of facilities financed with tax-exempt private activity bonds.

(a) *Scope.* This section applies for purposes of the rules for change of use of facilities financed with private activity bonds under sections 150(b)(3) (relating to qualified 501(c)(3) bonds), 150(b)(4) (relating to certain exempt facility bonds and small issue bonds), 150(b)(5) (relating to facilities required to be owned by governmental units or 501(c)(3) organizations), and 150(c).

(b) *Effect of remedial actions—(1) In general.* Except as provided in this section, the change of use provisions of sections 150(b)(3) through (5), and 150(c) apply even if the issuer takes a remedial action described in §§ 1.142-2, 1.144-2, or 1.145-2.

(2) *Exceptions—(i) Redemption.* If nonqualified bonds are redeemed within 90 days of a deliberate action under § 1.145-2(a) or within 90 days of the date on which a failure to properly use

proceeds occurs under § 1.142-2 or § 1.144-2, sections 150(b)(3) through (5) do not apply during the period between that date and the date on which the nonqualified bonds are redeemed.

(ii) *Alternative qualifying use of facility.* If a bond-financed facility is used for an alternative qualifying use under §§ 1.145-2 and 1.141-12(f), sections 150(b)(3) and (5) do not apply because of the alternative use.

(iii) *Alternative use of disposition proceeds.* If disposition proceeds are used for a qualifying purpose under §§ 1.145-2 and 1.141-12(e), 1.142-2(c)(4), or 1.144-2, sections 150(b)(3) through (5) do not apply because of the deliberate action that gave rise to the disposition proceeds after the date on which all of the disposition proceeds have been expended on the qualifying purpose. If all of the disposition proceeds are so expended within 90 days of the date of the deliberate action, however, sections 150(b)(3) through (5) do not apply because of the deliberate action.

(c) *Allocation rules—(1) In general.* If a change in use of a portion of the property financed with an issue of qualified private activity bonds causes section 150(b)(3), (b)(4), or (b)(5) to apply to an issue, the bonds of the issue allocable to that portion under section 150(c)(3) are the same as the nonqualified bonds determined for purposes of §§ 1.142-1, 1.144-1, and 1.145-1, except that bonds allocable to all common areas are also allocated to that portion.

(2) *Special rule when remedial action is taken.* If an issuer takes a remedial action with respect to an issue of private activity bonds under §§ 1.142-2, 1.144-2, or 1.145-2, the bonds of the issue allocable to a portion of property are the same as the nonqualified bonds determined for purposes of those sections.

(d) *Effective dates.* For effective dates of this section, see § 1.141-16.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 14. The authority citation for part 602 continues to read as follows:
Authority: 26 U.S.C. 7805.

Par. 15. In § 602.101, paragraph (c) is amended by adding entries in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * *	* * *
1.141-1	1545-1451
1.141-12	1545-1451
1.142-2	1545-1451
* * *	* * *
1.148-6	1545-1451
* * *	* * *

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 30, 1996.

Donald C. Lubick,
Acting Assistant Secretary of the
Treasury.

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