

§ 1.148-5

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contract substantially contemporaneously with the issue date of the hedge bond.

(B) *Contract terminated.* If a contract to which this paragraph (h)(5)(iii) applies is terminated in connection with the issuance of the hedged bond, the amount paid or received, or deemed to be paid or received, by the issuer to terminate the contract is treated as an adjustment to the issue price of the hedged bond and as an adjustment to the sale proceeds of the hedged bond for purposes of section 148.

(C) *Contract not terminated.* If a contract to which this paragraph (h)(5)(iii) applies is not terminated substantially contemporaneously with the issue date of the hedged bond, no payments with respect to the hedge made by the issuer before the issue date of the hedged bond are taken into account under this section.

(iv) *Identification.* The identification required under paragraph (h)(2)(viii) of this section must specify the reasonably expected governmental purpose, issue price, maturity, and issue date of the hedged bond, the manner in which interest is reasonably expected to be computed, and whether paragraph (h)(5)(ii) or (h)(5)(iii) of this section applies to the contract. If an issuer identifies a contract under this paragraph (h)(5)(iv) that would be a qualified hedge with respect to the anticipated bond, but does not issue the anticipated bond on the identified issue date, the contract is taken into account as a qualified hedge of any bond of the issuer that is issued for the identified governmental purpose within a reasonable interval around the identified issue date of the anticipated bond.

(6) *Authority of the Commissioner.* The Commissioner, by publication of a revenue ruling or revenue procedure (see § 601.601(d)(2) of this chapter), may specify contracts that, although they do not meet the requirements of paragraph (h)(2) of this section, are qualified hedges or, although they do not meet the requirements of paragraph (h)(4) of this section, cause the hedged

bonds to be treated as fixed yield bonds.

[T.D. 8476, 58 FR 33524, June 18, 1993; 58 FR 44452, Aug. 23, 1993, as amended by T.D. 8538, 59 FR 24042, May 10, 1994; T.D. 8718, 62 FR 25507, May 9, 1997; T.D. 8838, 64 FR 48547, Sept. 7, 1999]

§ 1.148-5 Yield and valuation of investments.

(a) *In general.* This section provides rules for computing the yield and value of investments allocated to an issue for various purposes under section 148.

(b) *Yield on an investment—(1) In general.* Except as otherwise provided, the yield on an investment allocated to an issue is computed under the economic accrual method, using the same compounding interval and financial conventions used to compute the yield on the issue. The yield on an investment allocated to an issue is the discount rate that, when used in computing the present value as of the date the investment is first allocated to the issue of all unconditionally payable receipts from the investment, produces an amount equal to the present value of all unconditionally payable payments for the investment. For this purpose, *payments* means amounts to be actually or constructively paid to acquire the investment, and *receipts* means amounts to be actually or constructively received from the investment, such as earnings and return of principal. The yield on a variable rate investment is determined in a manner comparable to the determination of the yield on a variable rate issue. For an issue of qualified mortgage bonds, qualified veterans' mortgage bonds, or qualified student loan bonds on which interest is paid semiannually, all regular monthly loan payments to be received during a semiannual debt service period may be treated as received at the end of that period. In addition, for any conduit financing issue, payments made by the conduit borrower are not treated as paid until the conduit borrower ceases to receive the benefit of earnings on those amounts.

(2) *Yield on a separate class of investments—(i) In general.* For purposes of the yield restriction rules of section

148(a) and §1.148-2, yield is computed separately for each class of investments. For this purpose, in determining the yield on a separate class of investments, the yield on each individual investment within the class is blended with the yield on other individual investments within the class, whether or not held concurrently, by treating those investments as a single investment. The yields on investments that are not within the same class are not blended.

(ii) *Separate classes of investments.* Each of the following is a separate class of investments—

(A) Each category of yield restricted purpose investment and program investment that is subject to a different definition of *materially higher* under §1.148-2(d)(2);

(B) Yield-restricted nonpurpose investments; and

(C) All other nonpurpose investments;

(iii) *Permissive application of single investment rules to certain yield restricted investments for all purposes of section 148.* For all purposes of section 148, if an issuer reasonably expects as of the issue date to establish and maintain a sinking fund solely to reduce the yield on the investments in a refunding escrow, then the issuer may treat all of the yield restricted nonpurpose investments in the refunding escrow and that sinking fund as a single investment having a single yield, determined under this paragraph (b)(2). Thus, an issuer may not treat the nonpurpose investments in a reasonably required reserve fund and a refunding escrow as a single investment having a single yield under this paragraph (b)(2)(iii).

(iv) *Mandatory application of single investment rules for refunding escrows for all purposes of section 148.* For all purposes of section 148, in computing the yield on yield restricted investments allocable to proceeds (i.e., sale proceeds, investment proceeds, and transferred proceeds) of a refunding issue that are held in one or more refunding escrows, the individual investments are treated as a single investment having a single yield, whether or not held concurrently. For example, this single investment includes both the individual investments allocable to sale and in-

vestment proceeds of a refunding issue that are held in one refunding escrow for a prior issue and the investments allocable to transferred proceeds of that refunding issue that are held in another refunding escrow.

(3) *Investments to be held beyond issue's maturity or beyond temporary period.* In computing the yield on investments allocable to an issue that are to be held beyond the reasonably expected redemption date of the issue, those investments are treated as sold for an amount equal to their value on that date. In computing the yield on investments that are held beyond an applicable temporary period under §1.148-2, for purposes of §1.148-2 those investments may be treated as purchased for an amount equal to their fair market value as of the end of the temporary period.

(4) *Consistent redemption assumptions on purpose investments.* The yield on purpose investments allocable to an issue is computed using the same redemption assumptions used to compute the yield on the issue. Yield on purpose investments allocable to an issue of qualified mortgage bonds and qualified veterans' mortgage bonds must be determined in a manner that is consistent with, and using the assumptions required by, section 143(g)(2)(B).

(5) *Student loan special allowance payments included in yield.* Except as provided in §1.148-11(e), the yield on qualified student loans is computed by including as receipts any special allowance payments made by the Secretary of Education pursuant to section 438 of the Higher Education Act of 1965.

(c) *Yield reduction payments to the United States—*(1) *In general.* In determining the yield on an investment to which this paragraph (c) applies, any amount paid to the United States in accordance with this paragraph (c), including a rebate amount, is treated as a payment for that investment that reduces the yield on that investment.

(2) *Manner of payment—*(i) *In general.* Except as otherwise provided in paragraph (c)(2)(ii) of this section, an amount is paid under this paragraph (c) if it is paid to the United States at the same time and in the same manner as rebate amounts are required to be paid

or at such other time or in such manner as the Commissioner may prescribe. For example, yield reduction payments must be made on or before the date of required rebate installment payments as described in §§1.148-3(f), (g), and (h). The provisions of §1.148-3(i) apply to payments made under this paragraph (c).

(ii) *Special rule for purpose investments.* For purpose investments allocable to an issue—

(A) No amounts are required to be paid to satisfy this paragraph (c) until the earlier of the end of the tenth bond year after the issue date of the issue or 60 days after the date on which the issue is no longer outstanding; and

(B) For payments made prior to the date on which the issue is retired, the issuer need not pay more than 75 percent of the amount otherwise required to be paid as of the date to which the payment relates.

(3) *Applicability of special yield reduction rule—(i) Covered investments.* This paragraph (c) applies to—

(A) Nonpurpose investments allocable to proceeds of an issue that qualified for one of the temporary periods available for capital projects, restricted working capital expenditures, pooled financings, or investment proceeds under §1.148-2(e)(2), (e)(3), (e)(4), or (e)(6), respectively;

(B) Investments allocable to a variable yield issue during any computation period in which at least 5 percent of the value of the issue is represented by variable yield bonds, unless the issue is an issue of hedge bonds (as defined in section 149(g)(3)(A));

(C) Nonpurpose investments allocable to transferred proceeds of—

(1) A current refunding issue to the extent necessary to reduce the yield on those investments to satisfy yield restrictions under section 148(a); or

(2) An advance refunding issue to the extent that investment of the refunding escrows allocable to the proceeds, other than transferred proceeds, of the refunding issue in zero-yielding nonpurpose investments is insufficient to satisfy yield restrictions under section 148(a);

(D) Purpose investments allocable to qualified student loans under a program described in section 144(b)(1)(A);

(E) Nonpurpose investments allocable to gross proceeds of an issue in a reasonably required reserve or replacement fund or in a fund that, except for its failure to satisfy the size limitation in §1.148-2(f)(2)(ii), would qualify as a reasonably required reserve or replacement fund, but only to the extent that—

(1) The value of the nonpurpose investments in the fund is not greater than 15 percent of the stated principal amount of the issue, as computed under §1.148-2(f)(2)(ii), or

(2) The amounts in the fund (other than investment earnings) are not reasonably expected to be used to pay debt service on the issue other than in connection with reductions in the amount required to be in that fund (e.g. a reserve fund for a revolving fund loan program);

(F) Nonpurpose investments allocated to replacement proceeds of a refunded issue as a result of the application of the universal cap to amounts in a refunding escrow (see §1.148-11(c)(1)(ii)); and

(G) Investments described in §1.148-11(f).

(ii) *Exception to yield reduction payments rule for advance refunding issues.* Paragraph (c)(1) of this section does not apply to investments allocable to gross proceeds of an advance refunding issue, other than—

(A) Transferred proceeds to which paragraph (c)(3)(i)(C) of this section applies;

(B) Replacement proceeds to which paragraph (c)(3)(i)(F) of this section applies; and

(C) Transferred proceeds to which paragraph (c)(3)(i)(E) of this section applies, but only to the extent necessary to satisfy yield restriction under section 148(a) on those proceeds treating all investments allocable to those proceeds as a separate class.

(d) *Value of investments—(1) In general.* Except as otherwise provided, the value of an investment (including a payment or receipt on the investment) on a date must be determined using one of the following valuation methods consistently for all purposes of section 148 to that investment on that date:

(i) *Plain par investment—outstanding principal amount.* A plain par investment may be valued at its outstanding stated principal amount, plus any accrued unpaid interest on that date.

(ii) *Fixed rate investment—present value.* A fixed rate investment may be valued at its present value on that date.

(iii) *Any investment—fair market value.* An investment may be valued at its fair market value on that date.

(2) *Mandatory valuation of yield restricted investments at present value.* Any yield restricted investment must be valued at present value. For example, a purpose investment or an investment allocable to gross proceeds in a refunding escrow after the expiration of the initial temporary period must be valued at present value. See, however, paragraph (b)(3) of this section.

(3) *Mandatory valuation of certain investments at fair market value—(i) In general.* Except as provided in paragraphs (d)(2), (d)(3)(ii), and (d)(4) of this section, an investment must be valued at fair market value on the date that it is first allocated to an issue or first ceases to be allocated to an issue as a consequence of a deemed acquisition or deemed disposition. For example, if an issuer deposits existing investments into a sinking fund for an issue, those investments must be valued at fair market value as of the date first deposited into the fund.

(ii) *Exception to fair market value requirement for transferred proceeds allocations, universal cap allocations, and commingled funds.* Paragraph (d)(3)(i) of this section does not apply if the investment is allocated from one issue to another issue as a result of the transferred proceeds allocation rule under § 1.148-9(b) or the universal cap rule under § 1.148-6(b)(2), provided that both issues consist exclusively of tax-exempt bonds. In addition, paragraph (d)(3)(i) of this section does not apply to investments in a commingled fund (other than a bona fide debt service fund) unless it is an investment being initially deposited in or withdrawn from a commingled fund described in § 1.148-6(e)(5)(iii).

(4) *Special transition rule for transferred proceeds.* The value of a nonpurpose investment that is allocated to

transferred proceeds of a refunding issue on a transfer date may not exceed the value of that investment on the transfer date used for purposes of applying the arbitrage restrictions to the refunded issue.

(5) *Definition of present value of an investment.* Except as otherwise provided, present value of an investment is computed under the economic accrual method, using the same compounding interval and financial conventions used to compute the yield on the issue. The present value of an investment on a date is equal to the present value of all unconditionally payable receipts to be received from and payments to be paid for the investment after that date, using the yield on the investment as the discount rate.

(6) *Definition of fair market value—(i) In general.* The fair market value of an investment is the price at which a willing buyer would purchase the investment from a willing seller in a bona fide, arm's-length transaction. Fair market value generally is determined on the date on which a contract to purchase or sell the nonpurpose investment becomes binding (i.e., the trade date rather than the settlement date). Except as otherwise provided in this paragraph (d)(6), an investment that is not of a type traded on an established securities market, within the meaning of section 1273, is rebuttably presumed to be acquired or disposed of for a price that is not equal to its fair market value. The fair market value of a United States Treasury obligation that is purchased directly from the United States Treasury is its purchase price.

(ii) *Safe harbor for establishing fair market value for certificates of deposit.* This paragraph (d)(6)(ii) applies to a certificate of deposit that has a fixed interest rate, a fixed payment schedule, and a substantial penalty for early withdrawal. The purchase price of such a certificate of deposit is treated as its fair market value on the purchase date if the yield on the certificate of deposit is not less than—

(A) The yield on reasonably comparable direct obligations of the United States; and

(B) The highest yield that is published or posted by the provider to be currently available from the provider

on reasonably comparable certificates of deposit offered to the public.

(iii) *Safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.* The purchase price of a guaranteed investment contract and the purchase price of an investment purchased for a yield restricted defeasance escrow will be treated as the fair market value of the investment on the purchase date if all of the following requirements are satisfied:

(A) The issuer makes a bona fide solicitation for the purchase of the investment. A bona fide solicitation is a solicitation that satisfies all of the following requirements:

(1) The bid specifications are in writing and are timely forwarded to potential providers.

(2) The bid specifications include all material terms of the bid. A term is material if it may directly or indirectly affect the yield or the cost of the investment.

(3) The bid specifications include a statement notifying potential providers that submission of a bid is a representation that the potential provider did not consult with any other potential provider about its bid, that the bid was determined without regard to any other formal or informal agreement that the potential provider has with the issuer or any other person (whether or not in connection with the bond issue), and that the bid is not being submitted solely as a courtesy to the issuer or any other person for purposes of satisfying the requirements of paragraph (d)(6)(iii)(B)(1) or (2) of this section.

(4) The terms of the bid specifications are commercially reasonable. A term is commercially reasonable if there is a legitimate business purpose for the term other than to increase the purchase price or reduce the yield of the investment. For example, for solicitations of investments for a yield restricted defeasance escrow, the hold firm period must be no longer than the issuer reasonably requires.

(5) For purchases of guaranteed investment contracts only, the terms of the solicitation take into account the issuer's reasonably expected deposit

and drawdown schedule for the amounts to be invested.

(6) All potential providers have an equal opportunity to bid. For example, no potential provider is given the opportunity to review other bids (i.e., a last look) before providing a bid.

(7) At least three reasonably competitive providers are solicited for bids. A reasonably competitive provider is a provider that has an established industry reputation as a competitive provider of the type of investments being purchased.

(B) The bids received by the issuer meet all of the following requirements:

(1) The issuer receives at least three bids from providers that the issuer solicited under a bona fide solicitation meeting the requirements of paragraph (d)(6)(iii)(A) of this section and that do not have a material financial interest in the issue. A lead underwriter in a negotiated underwriting transaction is deemed to have a material financial interest in the issue until 15 days after the issue date of the issue. In addition, any entity acting as a financial advisor with respect to the purchase of the investment at the time the bid specifications are forwarded to potential providers has a material financial interest in the issue. A provider that is a related party to a provider that has a material financial interest in the issue is deemed to have a material financial interest in the issue.

(2) At least one of the three bids described in paragraph (d)(6)(iii)(B)(1) of this section is from a reasonably competitive provider, within the meaning of paragraph (d)(6)(iii)(A)(7) of this section.

(3) If the issuer uses an agent to conduct the bidding process, the agent did not bid to provide the investment.

(C) The winning bid meets the following requirements:

(1) *Guaranteed investment contracts.* If the investment is a guaranteed investment contract, the winning bid is the highest yielding bona fide bid (determined net of any broker's fees).

(2) *Other investments.* If the investment is not a guaranteed investment contract, the following requirements are met:

(i) The winning bid is the lowest cost bona fide bid (including any broker's

fees). The lowest cost bid is either the lowest cost bid for the portfolio or, if the issuer compares the bids on an investment-by-investment basis, the aggregate cost of a portfolio comprised of the lowest cost bid for each investment. Any payment received by the issuer from a provider at the time a guaranteed investment contract is purchased (e.g., an escrow float contract) for a yield restricted defeasance escrow under a bidding procedure meeting the requirements of this paragraph (d)(6)(iii) is taken into account in determining the lowest cost bid.

(ii) The lowest cost bona fide bid (including any broker's fees) is not greater than the cost of the most efficient portfolio comprised exclusively of State and Local Government Series Securities from the United States Department of the Treasury, Bureau of Public Debt. The cost of the most efficient portfolio of State and Local Government Series Securities is to be determined at the time that bids are required to be submitted pursuant to the terms of the bid specifications.

(iii) If State and Local Government Series Securities from the United States Department of the Treasury, Bureau of Public Debt are not available for purchase on the day that bids are required to be submitted pursuant to terms of the bid specifications because sales of those securities have been suspended, the cost comparison of paragraph (d)(6)(iii) (C)(2)(ii) of this section is not required.

(D) The provider of the investments or the obligor on the guaranteed investment contract certifies the administrative costs that it pays (or expects to pay, if any) to third parties in connection with supplying the investment.

(E) The issuer retains the following records with the bond documents until three years after the last outstanding bond is redeemed:

(1) For purchases of guaranteed investment contracts, a copy of the contract, and for purchases of investments other than guaranteed investment contracts, the purchase agreement or confirmation.

(2) The receipt or other record of the amount actually paid by the issuer for the investments, including a record of any administrative costs paid by the

issuer, and the certification under paragraph (d)(6)(iii)(D) of this section.

(3) For each bid that is submitted, the name of the person and entity submitting the bid, the time and date of the bid, and the bid results.

(4) The bid solicitation form and, if the terms of the purchase agreement or the guaranteed investment contract deviated from the bid solicitation form or a submitted bid is modified, a brief statement explaining the deviation and stating the purpose for the deviation. For example, if the issuer purchases a portfolio of investments for a yield restricted defeasance escrow and, in order to satisfy the yield restriction requirements of section 148, an investment in the winning bid is replaced with an investment with a lower yield, the issuer must retain a record of the substitution and how the price of the substitute investment was determined. If the issuer replaces an investment in the winning bid portfolio with another investment, the purchase price of the new investment is not covered by the safe harbor unless the investment is bid under a bidding procedure meeting the requirements of this paragraph (d)(6)(iii).

(5) For purchases of investments other than guaranteed investment contracts, the cost of the most efficient portfolio of State and Local Government Series Securities, determined at the time that the bids were required to be submitted pursuant to the terms of the bid specifications.

(e) *Administrative costs of investments—*
(1) *In general.* Except as otherwise provided in this paragraph (e), an allocation of gross proceeds of an issue to a payment or a receipt on an investment is not adjusted to take into account any costs or expenses paid, directly or indirectly, to purchase, carry, sell, or retire the investment (administrative costs). Thus, these administrative costs generally do not increase the payments for, or reduce the receipts from, investments.

(2) *Qualified administrative costs on nonpurpose investments—*(i) *In general.* In determining payments and receipts on nonpurpose investments, qualified administrative costs are taken into account. Thus, qualified administrative

costs increase the payments for, or decrease the receipts from, the investments. Qualified administrative costs are reasonable, direct administrative costs, other than carrying costs, such as separately stated brokerage or selling commissions, but not legal and accounting fees, recordkeeping, custody, and similar costs. General overhead costs and similar indirect costs of the issuer such as employee salaries and office expenses and costs associated with computing the rebate amount under section 148(f) are not qualified administrative costs. In general, administrative costs are not reasonable unless they are comparable to administrative costs that would be charged for the same investment or a reasonably comparable investment if acquired with a source of funds other than gross proceeds of tax-exempt bonds.

(ii) *Special rule for administrative costs of nonpurpose investments in certain regulated investment companies and commingled funds.* Qualified administrative costs include all reasonable administrative costs, without regard to the limitation on indirect costs under paragraph (e)(2)(i) of this section, incurred by:

(A) *Regulated investment companies.* A publicly offered regulated investment company (as defined in section 67(c)(2)(B)); and

(B) *External commingled funds.* A widely held commingled fund in which no investor in the fund owns more than 10 percent of the beneficial interest in the fund. For purposes of this paragraph (e)(2)(ii)(B), a fund is treated as widely held only if, during the immediately preceding fixed, semiannual period chosen by the fund (e.g., semiannual periods ending June 30 and December 31), the fund had a daily average of more than 15 investors that were not related parties, and the daily average amount each investor had invested in the fund was not less than the lesser of \$500,000 and 1 percent of the daily average of the total amount invested in the fund. For purposes of this paragraph (e)(2)(ii)(B), an investor will be treated as owning not more than 10 percent of the beneficial interest in the fund if, on the date of each deposit by the investor into the fund, the total amount the investor and any related parties have on

deposit in the fund is not more than 10 percent of the total amount that all investors have on deposit in the fund. For purposes of the preceding sentence, the total amount that all investors have on deposit in the fund is equal to the sum of all deposits made by the investor and any related parties on the date of those deposits and the closing balance in the fund on the day before those deposits. If any investor in the fund owns more than 10 percent of the beneficial interest in the fund, the fund does not qualify under this paragraph (e)(2)(ii)(B) until that investor makes sufficient withdrawals from the fund to reduce its beneficial interest in the fund to 10 percent or less.

(iii) *Special rule for guaranteed investment contracts.* For a guaranteed investment contract, a broker's commission or similar fee paid on behalf of either an issuer or the provider is treated as an administrative cost and, except in the case of an issue that satisfies section 148(f)(4)(D)(i), is a qualified administrative cost to the extent that the present value of the commission, as of the date the contract is allocated to the issue, does not exceed the lesser of a reasonable amount within the meaning of paragraph (e)(2)(i) of this section or the present value of annual payments equal to .05 percent of the weighted average amount reasonably expected to be invested each year of the term of the contract. For this purpose, present value is computed using the taxable discount rate used by the parties to compute the commission or, if not readily ascertainable, the yield to the issuer on the investment contract or other reasonable taxable discount rate.

(iv) *Special rule for investments purchased for a yield restricted defeasance escrow.* For investments purchased for a yield restricted defeasance escrow, a fee paid to a bidding agent is a qualified administrative cost only if the following requirements are satisfied:

(A) The fee is comparable to a fee that would be charged for a reasonably comparable investment if acquired with a source of funds other than gross proceeds of tax-exempt bonds, and it is reasonable. The fee is deemed to be comparable to a fee that would be charged for a comparable investment

acquired with a source of funds other than gross proceeds of tax-exempt bonds, and to be reasonable if the fee does not exceed the lesser of \$10,000 or .1% of the initial principal amount of investments deposited in the yield restricted defeasance escrow.

(B) For transactions in which a guaranteed investment contract and other investments are purchased for a yield restricted defeasance escrow in a single investment (e.g., an issuer bids United States Treasury obligations and an escrow float contract collectively), a broker's fee described in paragraph (e)(2)(iv)(A) of this section will apply to the initial principal amount of the investment deposited in the yield restricted defeasance escrow, and a broker's fee described in paragraph (e)(2)(iii) of this section will apply only to the guaranteed investment contract portion of the investment.

(3) *Qualified administrative costs on purpose investments*—(i) *In general*. In determining payments and receipts on purpose investments, qualified administrative costs described in this paragraph (e)(3) paid by the conduit borrower are taken into account. Thus, these costs increase the payments for, or decrease the receipts from, the purpose investments. This rule applies even if those payments merely reimburse the issuer. Although the actual payments by the conduit borrower may be made at any time, for this purpose, a pro rata portion of each payment made by a conduit borrower is treated as a reimbursement of reasonable administrative costs, if the present value of those payments does not exceed the present value of the reasonable administrative costs paid by the issuer, using the yield on the issue as the discount rate.

(ii) *Definition of qualified administrative costs of purpose investments*—(A) *In general*. Except as otherwise provided in this paragraph (e)(3)(ii), qualified administrative costs of a purpose investment means—

(1) Costs or expenses paid, directly or indirectly, to purchase, carry, sell, or retire the investment; and

(2) Costs of issuing, carrying, or repaying the issue, and any underwriters' discount.

(B) *Limitation on program investments*. For a program investment, qualified administrative costs include only those costs described in paragraph (e)(3)(ii)(A)(2) of this section.

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§ 1.148-6 General allocation and accounting rules.

(a) *In general*—(1) *Reasonable accounting methods required*. An issuer may use any reasonable, consistently applied accounting method to account for gross proceeds, investments, and expenditures of an issue.

(2) *Bona fide deviations from accounting method*. An accounting method does not fail to be reasonable and consistently applied solely because a different accounting method is used for a bona fide governmental purpose to consistently account for a particular item. Bona fide governmental purposes may include special State law restrictions imposed on specific funds or actions to avoid grant forfeitures.

(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.

(b) *Allocation of gross proceeds to an issue*—(1) *One-issue rule and general ordering rules*. Except as otherwise provided, amounts are allocable to only one issue at a time as gross proceeds, and if amounts simultaneously are proceeds of one issue and replacement proceeds of another issue, those amounts are allocable to the issue of which they are proceeds. Amounts cease to be allocated to an issue as proceeds only when those amounts are allocated to an expenditure for a governmental purpose, are allocated to transferred proceeds of another issue, or cease to be allocated to that issue at retirement of the issue or under the universal cap of paragraph (b)(2) of this section. Amounts cease to be allocated to an issue as replacement proceeds only when those amounts are