transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101–508, set out as a note under section 45K of this title.

SUBPART B—REQUIREMENTS APPLICABLE TO ALL STATE AND LOCAL BONDS

Sec.
148. Arbitrage.
149. Bonds must be registered to be tax exempt; other requirements.

§ 148. Arbitrage

(a) Arbitrage bond defined

For purposes of section 103, the term ''arbitrage bond'' means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly—

(1) to acquire higher yielding investments, or

(2) to replace funds which were used directly or indirectly to acquire higher yielding investments.

For purposes of this subsection, a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in paragraph (1) or (2).

(b) Higher yielding investments

For purposes of this section—

(1) In general

The term ''higher yielding investments'' means any investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue.

(2) Investment property

The term ''investment property'' means—

(A) any security (within the meaning of section 165(g)(2)(A) or (B)),

(B) any obligation,

(C) any annuity contract,

(D) any investment-type property, or

(E) in the case of a bond other than a private activity bond, any residential rental property for family units which is not located within the jurisdiction of the issuer and which is not acquired to implement a court ordered or approved housing desegregation plan.

(3) Alternative minimum tax bonds treated as investment property in certain cases

(A) In general

Except as provided in subparagraph (B), the term ''investment property'' does not include any tax-exempt bond.

(B) Exception

With respect to an issue other than an issue a part of which is a specified private activity bond (as defined in section 57(a)(5)(C)), the term ''investment property'' includes a specified private activity bond (as so defined).

(4) Safe harbor for prepaid natural gas

(A) In general

The term ''investment-type property'' does not include a prepayment under a qualified natural gas supply contract.

(B) Qualified natural gas supply contract

For purposes of this paragraph, the term ''qualified natural gas supply contract'' means any contract to acquire natural gas for resale by a utility owned by a governmental unit if the amount of gas permitted to be acquired under the contract by the utility during any year does not exceed the sum of—

(i) the annual average amount during the testing period of natural gas purchased (other than for resale) by customers of such utility who are located within the service area of such utility, and

(ii) the amount of natural gas to be used to transport the prepaid natural gas to the utility during such year.

(C) Natural gas used to generate electricity

Natural gas used to generate electricity shall be taken into account in determining the average under subparagraph (B)(i)—

(i) only if the electricity is generated by a utility owned by a governmental unit, and

(ii) only to the extent that the electricity is sold (other than for resale) to customers of such utility who are located within the service area of such utility.

(D) Adjustments for changes in customer base

(i) New business customers

If—

(I) after the close of the testing period and before the date of issuance of the issue, the utility owned by a governmental unit enters into a contract to supply natural gas (other than for resale) for a business use at a property within the service area of such utility, and

(II) the utility did not supply natural gas to such property during the testing period or the ratable amount of natural gas to be supplied under the contract is significantly greater than the ratable amount of gas supplied to such property during the testing period,

then a contract shall not fail to be treated as a qualified natural gas supply contract by reason of supplying the additional natural gas under the contract referred to in subclause (I).

(ii) Lost customers

The average under subparagraph (B)(i) shall not exceed the annual amount of natural gas reasonably expected to be purchased (other than for resale) by persons who are located within the service area of such utility and who, as of the date of issuance of the issue, are customers of such utility.

(E) Ruling requests

The Secretary may increase the average under subparagraph (B)(i) for any period if

the utility owned by the governmental unit establishes to the satisfaction of the Secretary that, based on objective evidence of growth in natural gas consumption or population, such average would otherwise be insufficient for such period.

(F) Adjustment for natural gas otherwise on hand

(i) In general

The amount otherwise permitted to be acquired under the contract for any period shall be reduced by—

(I) the applicable share of natural gas held by the utility on the date of issuance of the issue, and

(II) the natural gas (not taken into account under subclause (I)) which the utility has a right to acquire during such period (determined as of the date of issuance of the issue).

(ii) Applicable share

For purposes of the clause (i), the term ''applicable share'' means, with respect to any period, the natural gas allocable to such period if the gas were allocated ratably over the period to which the prepayment relates.

(G) Intentional acts

Subparagraph (A) shall cease to apply to any issue if the utility owned by the governmental unit engages in any intentional act to render the volume of natural gas acquired by such prepayment to be in excess of the sum of—

(i) the amount of natural gas needed (other than for resale) by customers of such utility who are located within the service area of such utility, and

(ii) the amount of natural gas used to transport such natural gas to the utility.

(H) Testing period

For purposes of this paragraph, the term ''testing period'' means, with respect to an issue, the most recent 5 calendar years ending before the date of issuance of the issue.

(I) Service area

For purposes of this paragraph, the service area of a utility owned by a governmental unit shall be comprised of—

(i) any area throughout which such utility provided at all times during the testing period—

(I) in the case of a natural gas utility, natural gas transmission or distribution services, and

(II) in the case of an electric utility, electricity distribution services,

(ii) any area within a county contiguous to the area described in clause (i) in which retail customers of such utility are located if such area is not also served by another utility providing natural gas or electricity services, as the case may be, and

(iii) any area recognized as the service area of such utility under State or Federal law.

(c) Temporary period exception

(1) In general

For purposes of subsection (a), a bond shall not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such bond is a part may be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which such issue was issued.

(2) Limitation on temporary period for pooled financings

(A) In general

The temporary period referred to in paragraph (1) shall not exceed 6 months with respect to the proceeds of an issue which are to be used to make or finance loans (other than nonpurpose investments) to 2 or more persons.

(B) Shorter temporary period for loan repayments, etc.

Subparagraph (A) shall be applied by substituting ''3 months'' for ''6 months'' with respect to the proceeds from the sale or repayment of any loan which are to be used to make or finance any loan. For purposes of the preceding sentence, a nonpurpose investment shall not be treated as a loan.

(C) Bonds used to provide construction financing

In the case of an issue described in subparagraph (A) any portion of which is used to make or finance loans for construction expenditures (within the meaning of subsection (f)(4)(C)(iv))—

(i) rules similar to the rules of subsection (f)(4)(C)(v) shall apply, and

(ii) subparagraph (A) shall be applied with respect to such portion by substituting ''2 years'' for ''6 months''.

(D) Exception for mortgage revenue bonds

This paragraph shall not apply to any qualified mortgage bond or qualified veterans' mortgage bond.

(d) Special rules for reasonably required reserve or replacement fund

(1) In general

For purposes of subsection (a), a bond shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of the issue of which such bond is a part may be invested in higher yielding investments which are part of a reasonably required reserve or replacement fund. The amount referred to in the preceding sentence shall not exceed 10 percent of the proceeds of such issue unless the issuer establishes to the satisfaction of the Secretary that a higher amount is necessary.

(2) Limitation on amount in reserve or replacement fund which may be financed by issue

A bond issued as part of an issue shall be treated as an arbitrage bond if the amount of the proceeds from the sale of such issue which is part of any reserve or replacement fund exceeds 10 percent of the proceeds of the issue

(or such higher amount which the issuer establishes is necessary to the satisfaction of the Secretary).

(e) Minor portion may be invested in higher yielding investments

Notwithstanding subsections (a), (c), and (d), a bond issued as part of an issue shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of such issue (in addition to the amounts under subsections (c) and (d)) is invested in higher yielding investments if such amount does not exceed the lesser of—

(1) 5 percent of the proceeds of the issue, or

(2) $100,000.

(f) Required rebate to the United States

(1) In general

A bond which is part of an issue shall be treated as an arbitrage bond if the requirements of paragraphs (2) and (3) are not met with respect to such issue. The preceding sentence shall not apply to any qualified veterans' mortgage bond.

(2) Rebate to United States

An issue shall be treated as meeting the requirements of this paragraph only if an amount equal to the sum of—

(A) the excess of—

(i) the amount earned on all nonpurpose investments (other than investments attributable to an excess described in this subparagraph), over

(ii) the amount which would have been earned if such nonpurpose investments were invested at a rate equal to the yield on the issue, plus

(B) any income attributable to the excess described in subparagraph (A),

is paid to the United States by the issuer in accordance with the requirements of paragraph (3).

(3) Due date of payments under paragraph (2)

Except to the extent provided by the Secretary, the amount which is required to be paid to the United States by the issuer shall be paid in installments which are made at least once every 5 years. Each installment shall be in an amount which ensures that 90 percent of the amount described in paragraph (2) with respect to the issue at the time payment of such installment is required will have been paid to the United States. The last installment shall be made no later than 60 days after the day on which the last bond of the issue is redeemed and shall be in an amount sufficient to pay the remaining balance of the amount described in paragraph (2) with respect to such issue. A series of issues which are redeemed during a 6-month period (or such longer period as the Secretary may prescribe) shall be treated (at the election of the issuer) as 1 issue for purposes of the preceding sentence if no bond which is part of any issue in such series has a maturity of more than 270 days or is a private activity bond. In the case of a tax and revenue anticipation bond, the last installment shall not be required to be made before the date 8 months after the date of issuance of the issue of which the bond is a part.

(4) Special rules for applying paragraph (2)

(A) In general

In determining the aggregate amount earned on nonpurpose investments for purposes of paragraph (2)—

(i) any gain or loss on the disposition of a nonpurpose investment shall be taken into account, and

(ii) any amount earned on a bona fide debt service fund shall not be taken into account if the gross earnings on such fund for the bond year is less than $100,000.

In the case of an issue no bond of which is a private activity bond, clause (ii) shall be applied without regard to the dollar limitation therein if the average maturity of the issue (determined in accordance with section 147(b)(2)(A)) is at least 5 years and the rates of interest on bonds which are part of the issue do not vary during the term of the issue.

(B) Temporary investments

Under regulations prescribed by the Secretary—

(i) In general

An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraph (2) if—

(I) the gross proceeds of such issue are expended for the governmental purposes for which the issue was issued no later than the day which is 6 months after the date of issuance of the issue, and

(II) the requirements of paragraph (2) are met with respect to amounts not required to be spent as provided in subclause (I) (other than earnings on amounts in any bona fide debt service fund).

Gross proceeds which are held in a bona fide debt service fund or a reasonably required reserve or replacement fund, and gross proceeds which arise after such 6 months and which were not reasonably anticipated as of the date of issuance, shall not be considered gross proceeds for purposes of subclause (I) only.

(ii) Additional period for certain bonds

(I) In general

In the case of an issue described in subclause (II), clause (i) shall be applied by substituting ''1 year'' for ''6 months'' each place it appears with respect to the portion of the proceeds of the issue which are not expended in accordance with clause (i) if such portion does not exceed 5 percent of the proceeds of the issue.

(II) Issues to which subclause (I) applies

An issue is described in this subclause if no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond) or a tax or revenue anticipation bond.

(iii) Safe harbor for determining when proceeds of tax and revenue anticipation bonds are expended

(I) In general

For purposes of clause (i), in the case of an issue of tax or revenue anticipation bonds, the net proceeds of such issue (including earnings thereon) shall be treated as expended for the governmental purpose of the issue on the 1st day after the date of issuance that the cumulative cash flow deficit to be financed by such issue exceeds 90 percent of the proceeds of such issue.

(II) Cumulative cash flow deficit

For purposes of subclause (I), the term ''cumulative cash flow deficit'' means, as of the date of computation, the excess of the expenses paid during the period described in subclause (III) which would ordinarily be paid out of or financed by anticipated tax or other revenues over the aggregate amount available (other than from the proceeds of the issue) during such period for the payment of such expenses.

(III) Period involved

For purposes of subclause (II), the period described in this subclause is the period beginning on the date of issuance of the issue and ending on the earlier of the date 6 months after such date of issuance or the date of the computation of cumulative cash flow deficit.

(iv) Payments of principal not to affect requirements

For purposes of this subparagraph, payments of principal on the bonds which are part of an issue shall not be treated as expended for the governmental purposes of the issue.

(C) Exception from rebate for certain proceeds to be used to finance construction expenditures

(i) In general

In the case of a construction issue, paragraph (2) shall not apply to the available construction proceeds of such issue if the spending requirements of clause (ii) are met.

(ii) Spending requirements

The spending requirements of this clause are met if at least—

(I) 10 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 6-month period beginning on the date the bonds are issued,

(II) 45 percent of such proceeds are spent for such purposes within the 1-year period beginning on such date,

(III) 75 percent of such proceeds are spent for such purposes within the 18-month period beginning on such date, and

(IV) 100 percent of such proceeds are spent for such purposes within the 2-year period beginning on such date.

(iii) Exception for reasonable retainage

The spending requirement of clause (ii)(IV) shall be treated as met if—

(I) such requirement would be met at the close of such 2-year period but for a reasonable retainage (not exceeding 5 percent of the available construction proceeds of the construction issue), and

(II) 100 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 3-year period beginning on the date the bonds are issued.

(iv) Construction issue

For purposes of this subparagraph, the term ''construction issue'' means any issue if—

(I) at least 75 percent of the available construction proceeds of such issue are to be used for construction expenditures with respect to property which is to be owned by a governmental unit or a 501(c)(3) organization, and

(II) all of the bonds which are part of such issue are qualified 501(c)(3) bonds, bonds which are not private activity bonds, or private activity bonds issued to finance property to be owned by a governmental unit or a 501(c)(3) organization.

For purposes of this subparagraph, the term ''construction'' includes reconstruction and rehabilitation, and rules similar to the rules of section 142(b)(1)(B) shall apply.

(v) Portions of issues used for construction

If—

(I) all of the construction expenditures to be financed by an issue are to be financed from a portion thereof, and

(II) the issuer elects to treat such portion as a construction issue for purposes of this subparagraph,

then, for purposes of this subparagraph and subparagraph (B), such portion shall be treated as a separate issue.

(vi) Available construction proceeds

For purposes of this subparagraph—

(I) In general

The term ''available construction proceeds'' means the amount equal to the issue price (within the meaning of sections 1273 and 1274) of the construction issue, increased by earnings on the issue price, earnings on amounts in any reasonably required reserve or replacement fund not funded from the issue, and earnings on all of the foregoing earnings, and reduced by the amount of the issue price in any reasonably required reserve or replacement fund and the issuance costs financed by the issue.

(II) Earnings on reserve included only for certain periods

The term ''available construction proceeds'' shall not include amounts earned

on any reasonably required reserve or replacement fund after the earlier of the close of the 2-year period described in clause (ii) or the date the construction is substantially completed.

(III) Payments on acquired purpose obligations excluded

The term ''available construction proceeds'' shall not include payments on any obligation acquired to carry out the governmental purposes of the issue and shall not include earnings on such payments.

(IV) Election to rebate on earnings on reserve

At the election of the issuer, the term ''available construction proceeds'' shall not include earnings on any reasonably required reserve or replacement fund.

(vii) Election to pay penalty in lieu of rebate

(I) In general

At the election of the issuer, paragraph (2) shall not apply to available construction proceeds which do not meet the spending requirements of clause (ii) if the issuer pays a penalty, with respect to each 6-month period after the date the bonds were issued, equal to 1½ percent of the amount of the available construction proceeds of the issue which, as of the close of such 6-month period, is not spent as required by clause (ii).

(II) Termination

The penalty imposed by this clause shall cease to apply only as provided in clause (viii) or after the latest maturity date of any bond in the issue (including any refunding bond with respect thereto).

(viii) Election to terminate 1½ percent penalty

At the election of the issuer (made not later than 90 days after the earlier of the end of the initial temporary period or the date the construction is substantially completed), the penalty under clause (vii) shall not apply to any 6-month period after the initial temporary period under subsection (c) if the requirements of subclauses (I), (II), and (III) are met.

(I) 3 percent penalty

The requirement of this subclause is met if the issuer pays a penalty equal to 3 percent of the amount of available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the close of such initial temporary period multiplied by the number of years (including fractions thereof) in the initial temporary period.

(II) Yield restriction at close of temporary period

The requirement of this subclause is met if the amount of the available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the close of such initial temporary period is invested at a yield not exceeding the yield on the issue or which is invested in any tax-exempt bond which is not investment property.

(III) Redemption of bonds at earliest call date

The requirement of this subclause is met if the amount of the available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the earliest date on which bonds may be redeemed is used to redeem bonds on such date.

(ix) Election to terminate 1½ percent penalty before end of temporary period

If—

(I) the construction to be financed by a construction issue is substantially completed before the end of the initial temporary period,

(II) the issuer identifies an amount of available construction proceeds which will not be spent for the governmental purposes of the issue,

(III) the issuer has made the election under clause (viii), and

(IV) the issuer makes an election under this clause before the close of the initial temporary period and not later than 90 days after the date the construction is substantially completed,

then clauses (vii) and (viii) shall be applied to the available construction proceeds so identified as if the initial temporary period ended as of the date the election is made.

(x) Failure to pay penalties

In the case of a failure (which is not due to willful neglect) to pay any penalty required to be paid under clause (vii) or (viii) in the amount or at the time prescribed therefor, the Secretary may treat such failure as not occurring if, in addition to paying such penalty, the issuer pays a penalty equal to the sum of—

(I) 50 percent of the amount which was not paid in accordance with clauses (vii) and (viii), plus

(II) interest (at the underpayment rate established under section 6621) on the portion of the amount which was not paid on the date required for the period beginning on such date.

The Secretary may waive all or any portion of the penalty under this clause. Bonds which are part of an issue with respect to which there is a failure to pay the amount required under this clause (and any refunding bond with respect thereto) shall be treated as not being, and as never having been, tax-exempt bonds.

(xi) Election for pooled financing bonds

At the election of the issuer of an issue the proceeds of which are to be used to make or finance loans (other than nonpur-

pose investments) to 2 or more persons, the periods described in clauses (ii) and (iii) shall begin on—

(I) the date the loan is made, in the case of loans made within the 1-year period after the date the bonds are issued, and

(II) the date following such 1-year period, in the case of loans made after such 1-year period.

If such an election applies to an issue, the requirements of paragraph (2) shall apply to amounts earned before the beginning of the periods determined under the preceding sentence.

(xii) Payments of principal not to affect requirements

For purposes of this subparagraph, payments of principal on the bonds which are part of the construction issue shall not be treated as an expenditure of the available construction proceeds of the issue.

(xiii) Refunding bonds

(I) In general

Except as provided in this clause, clause (vii)(II), and the last sentence of clause (x), this subparagraph shall not apply to any refunding bond and no proceeds of a refunded bond shall be treated for purposes of this subparagraph as proceeds of a refunding bond.

(II) Determination of construction portion of issue

For purposes of clause (v), any portion of an issue which is used to refund any issue (or portion thereof) shall be treated as a separate issue.

(III) Coordination with rebate requirement on refunding bonds

The requirements of paragraph (2) shall be treated as met with respect to earnings for any period if a penalty is paid under clause (vii) or (viii) with respect to such earnings for such period.

(xiv) Determination of initial temporary period

For purposes of this subpargraph,[1] the end of the initial temporary period shall be determined without regard to section 149(d)(3)(A)(iv).

(xv) Elections

Any election under this subparagraph (other than clauses (viii) and (ix)) shall be made on or before the date the bonds are issued; and, once made, shall be irrevocable.

(xvi) Time for payment of penalties

Any penalty under this subparagraph shall be paid to the United States not later than 90 days after the period to which the penalty relates.

(xvii) Treatment of bona fide debt service funds

If the spending requirements of clause (ii) are met with respect to the available construction proceeds of a construction issue, then paragraph (2) shall not apply to earnings on a bona fide debt service fund for such issue.

(D) Exception for governmental units issuing $5,000,000 or less of bonds

(i) In general

An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraphs (2) and (3) if—

(I) the issue is issued by a governmental unit with general taxing powers,

(II) no bond which is part of such issue is a private activity bond,

(III) 95 percent or more of the net proceeds of such issue are to be used for local governmental activities of the issuer (or of a governmental unit the jurisdiction of which is entirely within the jurisdiction of the issuer), and

(IV) the aggregate face amount of all tax-exempt bonds (other than private activity bonds) issued by such unit during the calendar year in which such issue is issued is not reasonably expected to exceed $5,000,000.

(ii) Aggregation of issuers

For purposes of subclause (IV) of clause (i)—

(I) an issuer and all entities which issue bonds on behalf of such issuer shall be treated as 1 issuer,

(II) all bonds issued by a subordinate entity shall, for purposes of applying such subclause to each other entity to which such entity is subordinate, be treated as issued by such other entity, and

(III) an entity formed (or, to the extent provided by the Secretary, availed of) to avoid the purposes of such subclause (IV) and all other entities benefiting thereby shall be treated as 1 issuer.

(iii) Certain refunding bonds not taken into account in determining small issuer status

There shall not be taken into account under subclause (IV) of clause (i) any bond issued to refund (other than to advance refund) any bond to the extent the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(iv) Certain issues issued by subordinate governmental units, etc., exempt from rebate requirement

An issue issued by a subordinate entity of a governmental unit with general taxing powers shall be treated as described in clause (i)(I) if the aggregate face amount of such issue does not exceed the lesser of—

(I) $5,000,000, or

(II) the amount which, when added to the aggregate face amount of other issues issued by such entity, does not exceed the portion of the $5,000,000 limitation under clause (i)(IV) which such governmental unit allocates to such entity.

[1] So in original. Probably should be ''subparagraph,''.

For purposes of the preceding sentence, an entity which issues bonds on behalf of a governmental unit with general taxing powers shall be treated as a subordinate entity of such unit. An allocation shall be taken into account under subclause (II) only if it is irrevocable and made before the issuance date of such issue and only to the extent that the limitation so allocated bears a reasonable relationship to the benefits received by such governmental unit from issues issued by such entity.

(v) Determination of whether refunding bonds eligible for exception from rebate requirement

If any portion of an issue is issued to refund other bonds, such portion shall be treated as a separate issue which does not meet the requirements of paragraphs (2) and (3) by reason of this subparagraph unless—

(I) the aggregate face amount of such issue does not exceed $5,000,000,

(II) each refunded bond was issued as part of an issue which was treated as meeting the requirements of paragraphs (2) and (3) by reason of this subparagraph,

(III) the average maturity date of the refunding bonds issued as part of such issue is not later than the average maturity date of the bonds to be refunded by such issue, and

(IV) no refunding bond has a maturity date which is later than the date which is 30 years after the date the original bond was issued.

Subclause (III) shall not apply if the average maturity of the issue of which the original bond was a part (and of the issue of which the bonds to be refunded are a part) is 3 years or less. For purposes of this clause, average maturity shall be determined in accordance with section 147(b)(2)(A).

(vi) Refundings of bonds issued under law prior to Tax Reform Act of 1986

If section 141(a) did not apply to any refunded bond, the issue of which such refunded bond was a part shall be treated as meeting the requirements of subclause (II) of clause (v) if—

(I) such issue was issued by a governmental unit with general taxing powers,

(II) no bond issued as part of such issue was an industrial development bond (as defined in section 103(b)(2), but without regard to subparagraph (B) of section 103(b)(3)) or a private loan bond (as defined in section 103(*o*)(2)(A), but without regard to any exception from such definition other than section 103(*o*)(2)(C)), and

(III) the aggregate face amount of all tax-exempt bonds (other than bonds described in subclause (II)) issued by such unit during the calendar year in which such issue was issued did not exceed $5,000,000.

References in subclause (II) to section 103 shall be to such section as in effect on the day before the date of the enactment of the Tax Reform Act of 1986. Rules similar to the rules of clauses (ii) and (iii) shall apply for purposes of subclause (III). For purposes of subclause (II) of clause (i), bonds described in subclause (II) of this clause to which section 141(a) does not apply shall not be treated as private activity bonds.

(vii) Increase in exception for bonds financing public school capital expenditures

Each of the $5,000,000 amounts in the preceding provisions of this subparagraph shall be increased by the lesser of $10,000,000 or so much of the aggregate face amount of the bonds as are attributable to financing the construction (within the meaning of subparagraph (C)(iv)) of public school facilities.

(5) Exemption from gross income of sum rebated

Gross income shall not include the sum described in paragraph (2). Notwithstanding any other provision of this title, no deduction shall be allowed for any amount paid to the United States under paragraph (2).

(6) Definitions

For purposes of this subsection and subsections (c) and (d)—

(A) Nonpurpose investment

The term ''nonpurpose investment'' means any investment property which—

(i) is acquired with the gross proceeds of an issue, and

(ii) is not acquired in order to carry out the governmental purpose of the issue.

(B) Gross proceeds

Except as otherwise provided by the Secretary, the gross proceeds of an issue include—

(i) amounts received (including repayments of principal) as a result of investing the original proceeds of the issue, and

(ii) amounts to be used to pay debt service on the issue.

(7) Penalty in lieu of loss of tax exemption

In the case of an issue which would (but for this paragraph) fail to meet the requirements of paragraph (2) or (3), the Secretary may treat such issue as not failing to meet such requirements if—

(A) no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond),

(B) the failure to meet such requirements is not due to willful neglect, and

(C) the issuer pays to the United States a penalty in an amount equal to the sum of—

(i) 50 percent of the amount which was not paid in accordance with paragraphs (2) and (3), plus

(ii) interest (at the underpayment rate established under section 6621) on the portion of the amount which was not paid on

the date required under paragraph (3) for the period beginning on such date.

The Secretary may waive all or any portion of the penalty under this paragraph.

(g) Student loan incentive payments

Except to the extent otherwise provided in regulations, payments made by the Secretary of Education pursuant to section 438 of the Higher Education Act of 1965 are not to be taken into account, for purposes of subsection (a)(1), in determining yields on student loan notes.

(h) Determinations of yield

For purposes of this section, the yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).

(i) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

(Added Pub. L. 99–514, title XIII, § 1301(b), Oct. 22, 1986, 100 Stat. 2641; amended Pub. L. 100–647, title I, § 1013(a)(14)–(16)(A), (17)(A), (B), (18), (19), (43)(A), (B), title IV, § 4005(d)(2), title V, § 5053(b), title VI, §§ 6177(a), (b), 6181(a), (b), 6183(a), Nov. 10, 1988, 102 Stat. 3539, 3540, 3542, 3545, 3646, 3678, 3726, 3727, 3729; Pub. L. 101–239, title VII, §§ 7652(a)–(d), 7814(c)(2), 7816(r), (t), Dec. 19, 1989, 103 Stat. 2385–2387, 2413, 2423; Pub. L. 101–508, title XI, § 11701(j)(1)–(6), Nov. 5, 1990, 104 Stat. 1388–508 to 1388–513; Pub. L. 105–34, title II, § 223(a), title XIV, §§ 1441–1444, Aug. 5, 1997, 111 Stat. 818, 1053, 1054; Pub. L. 107–16, title IV, § 421(a), June 7, 2001, 115 Stat. 64; Pub. L. 109–58, title XIII, § 1327(a), Aug. 8, 2005, 119 Stat. 1017; Pub. L. 109–222, title V, § 508(c), May 17, 2006, 120 Stat. 362.)

AMENDMENT OF SECTION

For termination of amendment by section 901 of Pub. L. 107–16, see Effective and Termination Dates of 2001 Amendment note below.

REFERENCES IN TEXT

The date of the enactment of the Tax Reform Act of 1986, referred to in subsec. (f)(4)(C)(vi), is the date of enactment of Pub. L. 99–514, which was approved Oct. 22, 1986.

Section 438 of the Higher Education Act of 1965, referred to in subsec. (g), is classified to section 1087–1 of Title 20, Education.

AMENDMENTS

2006—Subsec. (f)(4)(D)(ii)(II) to (IV). Pub. L. 109–222 redesignated subcls. (III) and (IV) as (II) and (III), respectively, and struck out former subcl. (II) which read as follows: ''all bonds issued by a governmental unit to make loans to other governmental units with general taxing powers not subordinate to such unit shall, for purposes of applying such subclause to such unit, be treated as not issued by such unit.''

2005—Subsec. (b)(4). Pub. L. 109–58 added par. (4).

2001—Subsec. (f)(4)(D)(vii). Pub. L. 107–16, §§ 421(a), 901, temporarily substituted ''the lesser of $10,000,000'' for ''the lesser of $5,000,000''. See Effective and Termination Dates of 2001 Amendment note below.

1997—Subsec. (c)(2)(B) to (E). Pub. L. 105–34, § 1444(a), redesignated subpars. (C) to (E) as (B) to (D), respectively, and struck out heading and text of former subpar. (B). Text read as follows: ''In the case of the proceeds of an issue to be used to make or finance loans under a program described in section 144(b)(1)(A), subparagraph (A) shall be applied by substituting '18 months' for '6 months'. The preceding sentence shall not apply to any bond issued after December 31, 1988.''

Subsec. (d)(3). Pub. L. 105–34, § 1443, struck out par. (3) which related to limitations on investment in nonpurpose investments.

Subsec. (f)(4)(B)(ii)(I). Pub. L. 105–34, § 1441, substituted ''5 percent of the proceeds of the issue'' for ''the lesser of 5 percent of the proceeds of the issue or $100,000''.

Subsec. (f)(4)(C)(xvii). Pub. L. 105–34, § 1442, added cl. (xvii).

Subsec. (f)(4)(D)(vii). Pub. L. 105–34, § 223(a), added cl. (vii).

Subsec. (f)(4)(E). Pub. L. 105–34, § 1444(b), struck out subpar. (E) which related to exception for certain qualified student loan bonds.

1990—Subsec. (c)(2)(D). Pub. L. 101–508, § 11701(j)(5), substituted ''subsection (f)(4)(C)(iv)'' for ''subsection (f)(4)(B)(iv)(IV)'' in introductory provisions and ''subsection (f)(4)(C)(v)'' for ''subsection (f)(4)(B)(iv)(VIII)'' in cl. (i).

Subsec. (c)(2)(D), (E). Pub. L. 101–508, § 11701(j)(6), made technical amendment to Pub. L. 101–239, § 7652(c). See 1989 Amendment note below.

Subsec. (f)(4)(B)(i). Pub. L. 101–508, § 11701(j)(2), substituted in last sentence ''replacement fund, and gross proceeds which arise after such 6 months and which were not reasonably anticipated as of the date of issuance, shall not be considered gross proceeds for purposes of subclause (I) only'' for ''replacement fund shall not be considered gross proceeds for purposes of this subparagraph only'' in concluding provisions.

Subsec. (f)(4)(B)(i)(II). Pub. L. 101–508, § 11701(j)(1), amended subcl. (II) generally. Prior to amendment, subcl. (II) read as follows: ''the requirements of paragraph (2) are met after such 6 months with respect to earnings on amounts in any reasonably required reserve or replacement fund.''

Subsec. (f)(4)(B)(iv). Pub. L. 101–508, § 11701(j)(4), amended cl. (iv) generally, substituting present provisions for provisions which provided for a special rule to be applied during a 2-year period for certain construction bonds from issues in which at least 75 percent of the net proceeds of the issue were to be used for construction expenditures with respect to property which was owned by a governmental unit or a 501(c)(3) organization.

Subsec. (f)(4)(C) to (E). Pub. L. 101–508, § 11701(j)(3)(A), (B), added subpar. (C) and redesignated former subpars. (C) and (D) as (D) and (E), respectively.

1989—Subsec. (c)(2)(D), (E). Pub. L. 101–239, § 7652(c), as amended by Pub. L. 101–508, § 11701(j)(6), added subpar. (D) and redesignated former subpar. (D) as (E).

Subsec. (d)(3)(E)(ii). Pub. L. 101–239, § 7814(c)(2), struck out ''a qualified mortgage bond or'' after ''in the case of''.

Subsec. (f)(4)(B)(i). Pub. L. 101–239, § 7652(a), amended cl. (i) generally. Prior to amendment, cl. (i) read as follows: ''An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraph (2) if the gross proceeds of such issue are expended for the governmental purpose for which the issue was issued by no later than the day which is 6 months after the date of issuance of such issue. Gross proceeds which are held in a bona fide debt service fund shall not be considered gross proceeds for purposes of this subparagraph only.''

Subsec. (f)(4)(B)(ii)(I). Pub. L. 101–239, § 7652(d), inserted ''each place it appears'' after '' '6 months' ''.

Subsec. (f)(4)(B)(iii)(III). Pub. L. 101–239, § 7816(r), substituted ''such date of issuance or the date'' for ''such date of issuance. or the date''.

Subsec. (f)(4)(B)(iv). Pub. L. 101–239, § 7652(b), added cl. (iv).

Subsec. (f)(4)(C)(ii)(II). Pub. L. 101–239, § 7816(t), substituted ''to make loans to'' for ''on behalf of''.

1988—Subsec. (b)(2). Pub. L. 100–647, § 1013(a)(43)(B), struck out at end ''Such term shall not include any tax-exempt bond.''

Subsec. (b)(2)(E). Pub. L. 100–647, §5053(b), added subpar. (E).

Subsec. (b)(3). Pub. L. 100–647, §1013(a)(43)(A), added par. (3).

Subsec. (d)(2). Pub. L. 100–647, §1013(a)(14), substituted ''any reserve or replacement fund'' for ''any fund described in paragraph (1)''.

Subsec. (f)(1). Pub. L. 100–647, §4005(d)(2), struck out ''qualified mortgage bond or'' after ''apply to any''.

Subsec. (f)(3). Pub. L. 100–647, §6177(b), inserted at end ''In the case of a tax and revenue anticipation bond, the last installment shall not be required to be made before the date 8 months after the date of issuance of the issue of which the bond is a part.''

Pub. L. 100–647, §1013(a)(15), inserted ''A series of issues which are redeemed during a 6-month period (or such longer period as the Secretary may prescribe) shall be treated (at the election of the issuer) as 1 issue for purposes of the preceding sentence if no bond which is part of any issue in such series has a maturity of more than 270 days or is a private activity bond.''

Subsec. (f)(4)(A). Pub. L. 100–647, §6181(a), (b), struck out ''unless the issuer otherwise elects,'' before ''any amount earned'' in cl. (ii) and inserted at end of subpar. (A) ''In the case of an issue no bond of which is a private activity bond, clause (ii) shall be applied without regard to the dollar limitation therein if the average maturity of the issue (determined in accordance with section 147(b)(2)(A)) is at least 5 years and the rates of interest on bonds which are part of the issue do not vary during the term of the issue.''

Subsec. (f)(4)(B)(iii)(I). Pub. L. 100–647, §1013(a)(16)(A), substituted ''proceeds'' for ''aggregate face amount''.

Subsec. (f)(4)(B)(iii)(III). Pub. L. 100–647, §6177(a), substituted ''the earlier of the date 6 months after such date of issuance.'' for ''the earliest of the maturity date of the issue, the date 6 months after such date of issuance,''.

Subsec. (f)(4)(C). Pub. L. 100–647, §1013(a)(17)(A), in heading substituted ''governmental units issuing $5,000,000 or less of bonds'' for ''small governmental units'', designated existing provision as cl. (i), inserted heading ''In general'', redesignated existing cls. (i) to (iv) as subcls. (I) to (IV) and realigned their margins, struck out last sentence providing that cl. (iv) not take into account any bond which is not outstanding at the time of a later issue or which is redeemed, other than in an advance refunding, from the net proceeds of the later issue, and added cls. (ii) to (vi).

Subsec. (f)(4)(C)(i)(IV). Pub. L. 100–647, §1013(a)(17)(B), struck out ''(and all subordinate entities thereof)'' after ''such unit''.

Subsec. (f)(4)(C)(ii). Pub. L. 100–647, §6183(a), added subcl. (II) and redesignated former subcls. (II) and (III) as (III) and (IV), respectively.

Subsec. (f)(4)(D)(i). Pub. L. 100–647, §1013(a)(18), inserted ''for a program'' before ''described in section 144(b)(1)(A)'' in introductory text, substituted ''such program'' for ''such a program'' in subcl. (I), and inserted at end ''Amounts designated as interest on student loans shall not be taken into account in determining whether the issuer is reimbursed for such costs. Except as otherwise hereafter provided in regulations prescribed by the Secretary, costs described in subclause (I) paid from amounts earned as described in the first sentence of this clause may also be taken into account in determining the yield on the student loans under a program described in section 144(b)(1)(A).''

Subsec. (f)(7)(B). Pub. L. 100–647, §1013(a)(19), substituted ''not due'' for ''due to reasonable cause and not''.

EFFECTIVE DATE OF 2006 AMENDMENT

Amendment by Pub. L. 109–222 applicable to bonds issued after May 17, 2006, see section 508(e) of Pub. L. 109–222, set out as a note under section 54 of this title.

EFFECTIVE DATE OF 2005 AMENDMENT

Amendment by Pub. L. 109–58 applicable to obligations issued after Aug. 8, 2005, see section 1327(d) of Pub. L. 109–58, set out as a note under section 141 of this title.

EFFECTIVE AND TERMINATION DATES OF 2001 AMENDMENT

Pub. L. 107–16, title IV, §421(b), June 7, 2001, 115 Stat. 65, provided that: ''The amendment made by subsection (a) [amending this section] shall apply to obligations issued in calendar years beginning after December 31, 2001.''

Amendment by Pub. L. 107–16 inapplicable to taxable, plan, or limitation years beginning after Dec. 31, 2010, and the Internal Revenue Code of 1986 to be applied and administered to such years as if such amendment had never been enacted, see section 901 of Pub. L. 107–16, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Section 223(b) of Pub. L. 105–34 provided that: ''The amendments made by this section [amending this section] shall apply to bonds issued after December 31, 1997.''

Section 1445 of title XIV of Pub. L. 105–34 provided that: ''The amendments made by this subtitle [subtitle B (§§1441–1445) of title XIV of Pub. L. 105–34, amending this section] shall apply to bonds issued after the date of the enactment of this Act [Aug. 5, 1997].''

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101–508 effective, except as otherwise provided, as if included in the provision of the Revenue Reconciliation Act of 1989, Pub. L. 101–239, title VII, to which such amendment relates, see section 11701(n) of Pub. L. 101–508, set out as a note under section 42 of this title.

Section 11701(j)(8) of Pub. L. 101–508 provided that: ''Section 148(f)(4)(C)(xiii)(II) of such Code (as added by this subsection) shall apply only to refunding bonds issued after August 3, 1990.''

EFFECTIVE DATE OF 1989 AMENDMENT

Section 7652(e) of Pub. L. 101–239 provided that: ''The amendments made by this section [amending this section] shall apply to bonds issued after the date of the enactment of this Act [Dec. 19, 1989].''

Amendment by sections 7814(c)(2) and 7816(r), (t) of Pub. L. 101–239 effective, except as otherwise provided, as if included in the provision of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100–647, to which such amendment relates, see section 7817 of Pub. L. 101–239, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Section 1013(a)(16)(B) of Pub. L. 100–647 provided that: ''The amendment made by subparagraph (A) [amending this section] shall apply to bonds issued after June 30, 1987.''

Section 1013(a)(17)(C) of Pub. L. 100–647 provided that: ''(i) Except as provided in clause (ii), the amendments made by this paragraph [amending this section] shall apply to bonds issued after June 30, 1987.

''(ii) At the election of an issuer (made at such time and in such manner as the Secretary of the Treasury or his delegate may prescribe), the amendments made by this paragraph shall apply to such issuer as if included in the amendments made by section 1301(a) of the Tax Reform Act of 1986 [amending section 103 of this title].''

Section 1013(a)(43)(C) of Pub. L. 100–647 provided that: ''The amendments made by this paragraph [amending this section] shall apply to obligations issued after March 31, 1988.''

Amendment by section 1013(a)(14), (15), (18), (19) of Pub. L. 100–647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99–514, to which such amendment relates, see section 1019(a) of Pub. L. 100–647, set out as a note under section 1 of this title.

Amendment by section 4005(d)(2) of Pub. L. 100–647 applicable to bonds issued, and nonissued bond amounts

elected, after Dec. 31, 1988, see section 4005(h)(1) of Pub. L. 100–647, set out as a note under section 143 of this title.

Amendment by section 5053(b) of Pub. L. 100–647 applicable, with certain exceptions, to obligations issued after Oct. 21, 1988, see section 5053(c) of Pub. L. 100–647, set out as a note under section 145 of this title.

Section 6177(c) of Pub. L. 100–647 provided that: ''The amendments made by this section [amending this section] shall apply to bonds issued after the date of the enactment of this Act [Nov. 10, 1988].''

Section 6181(c) of Pub. L. 100–647 provided that:

''(1) IN GENERAL.—The amendments made by this section [amending this section] shall apply to bonds issued after the date of the enactment of this Act [Nov. 10, 1988].

''(2) ELECTION FOR OUTSTANDING BONDS.—Any issue of bonds other than private activity bonds outstanding as of the date of the enactment of this Act shall be allowed a 1-time election to apply the amendments made by subsection (b) [amending this section] to amounts deposited after such date in bona fide debt service funds of such bonds.

''(3) DEFINITION OF PRIVATE ACTIVITY BOND.—For purposes of this section and the last sentence of section 148(f)(4)(A) of the 1986 Code (as added by subsection (b)), the term 'private activity bond' shall include any qualified 501(c)(3) bond (as defined under section 145 of the 1986 Code).''

Section 6183(b) of Pub. L. 100–647 provided that: ''The amendment made by subsection (a) [amending this section] shall apply to bonds issued after December 31, 1988.''

EFFECTIVE DATE

Subpart applicable to bonds issued after Aug. 15, 1986, except as otherwise provided, see sections 1311 to 1318 of Pub. L. 99–514, set out as an Effective Date; Transitional Rules note under section 141 of this title.

EXTENSION OF PERIOD TO ELECT TO TERMINATE PERCENT PENALTY FOR BONDS ISSUED BEFORE NOVEMBER 5, 1990

Section 11701(j)(7) of Pub. L. 101–508 provided that: ''In the case of a bond issued before the date of the enactment of this Act [Nov. 5, 1990], the period for making the election under section 148(f)(4)(C)(viii) of the Internal Revenue Code of 1986 (as added by this subsection) shall not expire before the date which is 180 days after such date of enactment.''

AMENDMENT TO ARBITRAGE REGULATIONS

Section 1301(c) of Pub. L. 99–514 provided that: ''The provision in the Federal income tax regulations relating to the arbitrage requirements which permits a higher yield on acquired obligations if the issuer elects to waive the benefits of the temporary period provisions shall not apply to bonds issued after August 31, 1986.''

§ 149. Bonds must be registered to be tax exempt; other requirements

(a) Bonds must be registered to be tax exempt

(1) General rule

Nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any registration-required bond unless such bond is in registered form.

(2) Registration-required bond

For purposes of paragraph (1), the term ''registration-required bond'' means any bond other than a bond which—

(A) is not of a type offered to the public,

(B) has a maturity (at issue) of not more than 1 year, or

(C) is described in section 163(f)(2)(B).

(3) Special rules

(A) Book entries permitted

For purposes of paragraph (1), a book entry bond shall be treated as in registered form if the right to the principal of, and stated interest on, such bond may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

(B) Nominees

The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where there is a nominee or chain of nominees.

(b) Federally guaranteed bond is not tax exempt

(1) In general

Section 103(a) shall not apply to any State or local bond if such bond is federally guaranteed.

(2) Federally guaranteed defined

For purposes of paragraph (1), a bond is federally guaranteed if—

(A) the payment of principal or interest with respect to such bond is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof),

(B) such bond is issued as part of an issue and 5 percent or more of the proceeds of such issue is to be—

(i) used in making loans the payment of principal or interest with respect to which are to be guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof), or

(ii) invested (directly or indirectly) in federally insured deposits or accounts, or

(C) the payment of principal or interest on such bond is otherwise indirectly guaranteed (in whole or in part) by the United States (or an agency or instrumentality thereof).

(3) Exceptions

(A) Certain insurance programs

A bond shall not be treated as federally guaranteed by reason of—

(i) any guarantee by the Federal Housing Administration, the Veterans' Administration, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association,

(ii) any guarantee of student loans and any guarantee by the Student Loan Marketing Association to finance student loans,

(iii) any guarantee by the Bonneville Power Authority pursuant to the Northwest Power Act (16 U.S.C. 839d) as in effect on the date of the enactment of the Tax Reform Act of 1984, or

(iv) subject to subparagraph (E), any guarantee by a Federal home loan bank made in connection with the original issuance of a bond during the period beginning on the date of the enactment of this clause and ending on December 31, 2010 (or a renewal or extension of a guarantee so made).

(B) Debt service, etc.

Paragraph (1) shall not apply to—

(i) proceeds of the issue invested for an initial temporary period until such proceeds are needed for the purpose for which such issue was issued,

(ii) investments of a bona fide debt service fund,

(iii) investments of a reserve which meet the requirements of section 148(d),

(iv) investments in bonds issued by the United States Treasury, or

(v) other investments permitted under regulations.

(C) Exception for housing programs

(i) In general

Except as provided in clause (ii), paragraph (1) shall not apply to—

(I) a private activity bond for a qualified residential rental project or a housing program obligation under section 11(b) of the United States Housing Act of 1937,

(II) a qualified mortgage bond, or

(III) a qualified veterans' mortgage bond.

(ii) Exception not to apply where bond invested in federally insured deposits or accounts

Clause (i) shall not apply to any bond which is federally guaranteed within the meaning of paragraph (2)(B)(ii).

(D) Loans to, or guarantees by, financial institutions

Except as provided in paragraph (2)(B)(ii), a bond which is issued as part of an issue shall not be treated as federally guaranteed merely by reason of the fact that the proceeds of such issue are used in making loans to a financial institution or there is a guarantee by a financial institution unless such guarantee constitutes a federally insured deposit or account.

(E) Safety and soundness requirements for Federal home loan banks

Clause (iv) of subparagraph (A) shall not apply to any guarantee by a Federal home loan bank unless such bank meets safety and soundness collateral requirements for such guarantees which are at least as stringent as such requirements which apply under regulations applicable to such guarantees by Federal home loan banks as in effect on April 9, 2008.

(4) Definitions

For purposes of this subsection—

(A) Treatment of certain entities with authority to borrow from United States

To the extent provided in regulations prescribed by the Secretary, any entity with statutory authority to borrow from the United States shall be treated as an instrumentality of the United States. Except in the case of an exempt facility bond, a qualified small issue bond, and a qualified student loan bond, nothing in the preceding sentence shall be construed as treating the District of Columbia or any possession of the United States as an instrumentality of the United States.

(B) Federally insured deposit or account

The term ''federally insured deposit or account'' means any deposit or account in a financial institution to the extent such deposit or account is insured under Federal law by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the National Credit Union Administration, or any similar federally chartered corporation.

(c) Tax exemption must be derived from this title

(1) General rule

Except as provided in paragraph (2), no interest on any bond shall be exempt from taxation under this title unless such interest is exempt from tax under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act.

(2) Certain prior exemptions

(A) Prior exemptions continued

For purposes of this title, notwithstanding any provision of this part, any bond the interest on which is exempt from taxation under this title by reason of any provision of law (other than a provision of this title) which is in effect on January 6, 1983, shall be treated as a bond described in section 103(a).

(B) Additional requirements for bonds issued after 1983

Subparagraph (A) shall not apply to a bond (not described in subparagraph (C)) issued after 1983 if the appropriate requirements of this part (or the corresponding provisions of prior law) are not met with respect to such bond.

(C) Description of bond

A bond is described in this subparagraph (and treated as described in subparagraph (A)) if—

(i) such bond is issued pursuant to the Northwest Power Act (16 U.S.C. 839d), as in effect on July 18, 1984;

(ii) such bond is issued pursuant to section 608(a)(6)(A) of Public Law 97–468, as in effect on the date of the enactment of the Tax Reform Act of 1986; or

(iii) such bond is issued before June 19, 1984 under section 11(b) of the United States Housing Act of 1937.

(d) Advance refundings

(1) In general

Nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue described in paragraph (2), (3), or (4).

(2) Certain private activity bonds

An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond).

(3) Other bonds

(A) In general

An issue is described in this paragraph if any bond (issued as part of such issue), hereinafter in this paragraph referred to as the ''refunding bond'', is issued to advance refund a bond unless—

(i) the refunding bond is only—

(I) the 1st advance refunding of the original bond if the original bond is issued after 1985, or

(II) the 1st or 2nd advance refunding of the original bond if the original bond was issued before 1986,

(ii) in the case of refunded bonds issued before 1986, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed at par or at a premium of 3 percent or less,

(iii) in the case of refunded bonds issued after 1985, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed,

(iv) the initial temporary period under section 148(c) ends—

(I) with respect to the proceeds of the refunding bond not later than 30 days after the date of issue of such bond, and

(II) with respect to the proceeds of the refunded bond on the date of issue of the refunding bond, and

(v) in the case of refunded bonds to which section 148(e) did not apply, on and after the date of issue of the refunding bond, the amount of proceeds of the refunded bond invested in higher yielding investments (as defined in section 148(b)) which are nonpurpose investments (as defined in section 148(f)(6)(A)) does not exceed—

(I) the amount so invested as part of a reasonably required reserve or replacement fund or during an allowable temporary period, and

(II) the amount which is equal to the lesser of 5 percent of the proceeds of the issue of which the refunded bond is a part or $100,000 (to the extent such amount is allocable to the refunded bond).

(B) Special rules for redemptions

(i) Issuer must redeem only if debt service savings

Clause (ii) and (iii) of subparagraph (A) shall apply only if the issuer may realize present value debt service savings (determined without regard to administrative expenses) in connection with the issue of which the refunding bond is a part.

(ii) Redemptions not required before 90th day

For purposes of clauses (ii) and (iii) of subparagraph (A), the earliest date referred to in such clauses shall not be earlier than the 90th day after the date of issuance of the refunding bond.

(4) Abusive transactions prohibited

An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund another bond and a device is employed in connection with the issuance of such issue to obtain a material financial advantage (based on arbitrage) apart from savings attributable to lower interest rates.

(5) Advance refunding

For purposes of this part, a bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

(6) Special rules for purposes of paragraph (3)

For purposes of paragraph (3), bonds issued before the date of the enactment of this subsection shall be taken into account under subparagraph (A)(i) thereof except—

(A) a refunding which occurred before 1986 shall be treated as an advance refunding only if the refunding bond was issued more than 180 days before the redemption of the refunded bond, and

(B) a bond issued before 1986, shall be treated as advance refunded no more than once before March 15, 1986.

(7) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.

(e) Information reporting

(1) In general

Nothing in section 103(a) or any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond unless such bond satisfies the requirements of paragraph (2).

(2) Information reporting requirements

A bond satisfies the requirements of this paragraph if the issuer submits to the Secretary, not later than the 15th day of the 2d calendar month after the close of the calendar quarter in which the bond is issued (or such later time as the Secretary may prescribe with respect to any portion of the statement), a statement concerning the issue of which the bond is a part which contains—

(A) the name and address of the issuer,

(B) the date of issue, the amount of net proceeds of the issue, the stated interest rate, term, and face amount of each bond which is part of the issue, the amount of issuance costs of the issue, and the amount of reserves of the issue,

(C) where required, the name of the applicable elected representative who approved the issue, or a description of the voter referendum by which the issue was approved,

(D) the name, address, and employer identification number of—

(i) each initial principal user of any facility provided with the proceeds of the issue,

(ii) the common parent of any affiliated group of corporations (within the meaning of section 1504(a)) of which such initial principal user is a member, and

(iii) if the issue is treated as a separate issue under section 144(a)(6)(A), any person treated as a principal user under section 144(a)(6)(B),

(E) a description of any property to be financed from the proceeds of the issue,

(F) a certification by a State official designated by State law (or, where there is no such official, the Governor) that the bond meets the requirements of section 146 (relating to cap on private activity bonds), if applicable, and

(G) such other information as the Secretary may require.

Subparagraphs (C) and (D) shall not apply to any bond which is not a private activity bond. The Secretary may provide that certain information specified in the 1st sentence need not be included in the statement with respect to an issue where the inclusion of such information is not necessary to carry out the purposes of this subsection.

(3) Extension of time

The Secretary may grant an extension of time for the filing of any statement required under paragraph (2) if the failure to file in a timely fashion is not due to willful neglect.

(f) Treatment of certain pooled financing bonds

(1) In general

Section 103(a) shall not apply to any pooled financing bond unless, with respect to the issue of which such bond is a part, the requirements of paragraphs (2), (3), (4), and (5) are met.

(2) Reasonable expectation requirement

(A) In general

The requirements of this paragraph are met with respect to an issue if the issuer reasonably expects that—

(i) as of the close of the 1-year period beginning on the date of issuance of the issue, at least 30 percent of the net proceeds of the issue (as of the close of such period) will have been used directly or indirectly to make or finance loans to ultimate borrowers, and

(ii) as of the close of the 3-year period beginning on such date of issuance, at least 95 percent of the net proceeds of the issue (as of the close of such period) will have been so used.

(B) Certain factors may not be taken into account in determining expectations

Expectations as to changes in interest rates or in the provisions of this title (or in the regulations or rulings thereunder) may not be taken into account in determining whether expectations are reasonable for purposes of this paragraph.

(C) Net proceeds

For purposes of subparagraph (A), the term ''net proceeds'' has the meaning given such term by section 150 but shall not include proceeds used to finance issuance costs and shall not include proceeds necessary to pay interest (during such period) on the bonds which are part of the issue.

(D) Refunding bonds

For purposes of subparagraph (A), in the case of a refunding bond, the date of issuance taken into account is the date of issuance of the original bond.

(3) Cost of issuance payment requirements

The requirements of this paragraph are met with respect to an issue if—

(A) the payment of legal and underwriting costs associated with the issuance of the issue is not contingent, and

(B) at least 95 percent of the reasonably expected legal and underwriting costs associated with the issuance of the issue are paid not later than the 180th day after the date of the issuance of the issue.

(4) Written loan commitment requirement

(A) In general

The requirement of this paragraph is met with respect to an issue if the issuer receives prior to issuance written loan commitments identifying the ultimate potential borrowers of at least 30 percent of the net proceeds of such issue.

(B) Exception

Subparagraph (A) shall not apply with respect to any issuer which—

(i) is a State (or an integral part of a State) issuing pooled financing bonds to make or finance loans to subordinate governmental units of such State, or

(ii) is a State-created entity providing financing for water-infrastructure projects through the federally-sponsored State revolving fund program.

(5) Redemption requirement

The requirement of this paragraph is met if to the extent that less than the percentage of the proceeds of an issue required to be used under clause (i) or (ii) of paragraph (2)(A) is used by the close of the period identified in such clause, the issuer uses an amount of proceeds equal to the excess of—

(A) the amount required to be used under such clause, over

(B) the amount actually used by the close of such period,

to redeem outstanding bonds within 90 days after the end of such period.

(6) Pooled financing bond

For purposes of this subsection—

(A) In general

The term ''pooled financing bond'' means any bond issued as part of an issue more than $5,000,000 of the proceeds of which are reasonably expected (at the time of the issuance of the bonds) to be used (or are intentionally used) directly or indirectly to make or finance loans to 2 or more ultimate borrowers.

(B) Exceptions

Such term shall not include any bond if—

(i) section 146 applies to the issue of which such bond is a part (other than by reason of section 141(b)(5)) or would apply but for section 146(i), or

(ii) section 143(*l*)(3) applies to such issue.

(7) Definition of loan; treatment of mixed use issues

(A) Loan

For purposes of this subsection, the term ''loan'' does not include—

(i) any loan which is a nonpurpose investment (within the meaning of section 148(f)(6)(A), determined without regard to section 148(b)(3)), and

(ii) any use of proceeds by an agency of the issuer unless such agency is a political subdivision or instrumentality of the issuer.

(B) Portion of issue to be used for loans treated as separate issue

If only a portion of the proceeds of an issue is reasonably expected (at the time of issuance of the bond) to be used (or is intentionally used) as described in paragraph (6)(A), such portion and the other portion of such issue shall be treated as separate issues for purposes of determining whether such portion meets the requirements of this subsection.

(g) Treatment of hedge bonds

(1) In general

Section 103(a) shall not apply to any hedge bond unless, with respect to the issue of which such bond is a part—

(A) the requirement of paragraph (2) is met, and

(B) the requirement of subsection (f)(3) is met.

(2) Reasonable expectations as to when proceeds will be spent

An issue meets the requirement of this paragraph if the issuer reasonably expects that—

(A) 10 percent of the spendable proceeds of the issue will be spent for the governmental purposes of the issue within the 1-year period beginning on the date the bonds are issued,

(B) 30 percent of the spendable proceeds of the issue will be spent for such purposes within the 2-year period beginning on such date,

(C) 60 percent of the spendable proceeds of the issue will be spent for such purposes within the 3-year period beginning on such date, and

(D) 85 percent of the spendable proceeds of the issue will be spent for such purposes within the 5-year period beginning on such date.

(3) Hedge bond

(A) In general

For purposes of this subsection, the term ''hedge bond'' means any bond issued as part of an issue unless—

(i) the issuer reasonably expects that 85 percent of the spendable proceeds of the issue will be used to carry out the governmental purposes of the issue within the 3-year period beginning on the date the bonds are issued, and

(ii) not more than 50 percent of the proceeds of the issue are invested in nonpurpose investments (as defined in section 148(f)(6)(A)) having a substantially guaranteed yield for 4 years or more.

(B) Exception for investment in tax-exempt bonds not subject to minimum tax

(i) In general

Such term shall not include any bond issued as part of an issue 95 percent of the net proceeds of which are invested in bonds—

(I) the interest on which is not includible in gross income under section 103, and

(II) which are not specified private activity bonds (as defined in section 57(a)(5)(C)).

(ii) Amounts in bona fide debt service fund

Amounts in a bona fide debt service fund shall be treated as invested in bonds described in clause (i).

(iii) Amounts held pending reinvestment or redemption

Amounts held for not more than 30 days pending reinvestment or bond redemption shall be treated as invested in bonds described in clause (i).

(C) Exception for refunding bonds

(i) In general

A refunding bond shall be treated as meeting the requirements of this subsection only if the original bond met such requirements.

(ii) General rule for refunding of pre-effective date bonds

A refunding bond shall be treated as meeting the requirements of this subsection if—

(I) this subsection does not apply to the original bond,

(II) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue, and

(III) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(iii) Refunding of pre-effective date bonds entitled to 5-year temporary period

A refunding bond shall be treated as meeting the requirements of this subsection if—

(I) this subsection does not apply to the original bond,

(II) the issuer reasonably expected that 85 percent of the spendable proceeds of the issue of which the original bond is a part would be used to carry out the governmental purposes of the issue within the 5-year period beginning on the date the original bonds were issued but did not reasonably expect that 85 percent of such proceeds would be so spent within the 3-year period beginning on such date, and

(III) at least 85 percent of the spendable proceeds of the original issue (and

all other prior original issues issued to finance the governmental purposes of such issue) were spent before the date the refunding bonds are issued.

(4) Special rules

For purposes of this subsection—

(A) Construction period in excess of 5 years

The Secretary may, at the request of any issuer, provide that the requirement of paragraph (2) shall be treated as met with respect to the portion of the spendable proceeds of an issue which is to be used for any construction project having a construction period in excess of 5 years if it is reasonably expected that such proceeds will be spent over a reasonable construction schedule specified in such request.

(B) Rules for determining expectations

The rules of subsection (f)(2)(B) shall apply.

(5) Regulations

The Secretary may prescribe regulations to prevent the avoidance of the rules of this subsection, including through the aggregation of projects within a single issue.

(Added Pub. L. 99–514, title XIII, §1301(b), Oct. 22, 1986, 100 Stat. 2646; amended Pub. L. 100–647, title I, §1013(a)(20)–(22), title V, §5051(a), Nov. 10, 1988, 102 Stat. 3542, 3676; Pub. L. 101–239, title VII, §7651(a), Dec. 19, 1989, 103 Stat. 2383; Pub. L. 104–188, title I, §1704(b)(1), Aug. 20, 1996, 110 Stat. 1878; Pub. L. 109–222, title V, §508(a), (b), (d)(1), (2), May 17, 2006, 120 Stat. 361, 362; Pub. L. 110–289, div. C, title I, §3023(a), (b), July 30, 2008, 122 Stat. 2894, 2895.)

REFERENCES IN TEXT

The Northwest Power Act, referred to in subsecs. (b)(3)(A)(iii) and (c)(2)(C)(i), probably means the Pacific Northwest Electric Power Planning and Conservation Act, Pub. L. 96–501, Dec. 5, 1980, 94 Stat 2697, which is classified principally to chapter 12H (§839 et seq.) of Title 16, Conservation. For complete classification of this Act to the Code, see Short Title note set out under section 839 of Title 16 and Tables.

The date of the enactment of the Tax Reform Act of 1984, referred to in subsec. (b)(3)(A)(iii), is the date of enactment of Pub. L. 98–369, div. A, which was approved July 18, 1984.

The date of the enactment of this clause, referred to in subsec. (b)(3)(A)(iv), is the date of enactment of Pub. L. 110–289, which was approved July 30, 2008.

Section 11(b) of the United States Housing Act of 1937, referred to in subsecs. (b)(3)(C)(i)(I) and (c)(2)(C)(iii), is classified to section 1473i(b) of Title 42, The Public Health and Welfare.

Section 608(a)(6)(A) of Pub. L. 97–468, referred to in subsec. (c)(2)(C)(ii), is classified to section 1207(a)(6)(A) of Title 45, Railroads.

The date of the enactment of the Tax Reform Act of 1986, referred to in subsec. (c)(2)(C)(ii), is the date of enactment of Pub. L. 99–514, which was approved Oct. 22, 1986.

The date of the enactment of this subsection, referred to in subsec. (d)(6), is the date of enactment of Pub. L. 99–514, which was approved Oct. 22, 1986.

AMENDMENTS

2008—Subsec. (b)(3)(A)(iv). Pub. L. 110–289, §3023(a), added cl. (iv).

Subsec. (b)(3)(E). Pub. L. 110–289, §3023(b), added subpar. (E).

2006—Subsec. (f)(1). Pub. L. 109–222, §508(d)(1), substituted ''paragraphs (2), (3), (4), and (5)'' for ''paragraphs (2) and (3)''.

Subsec. (f)(2)(A). Pub. L. 109–222, §508(a), amended subpar. (A) generally. Prior to amendment, text read as follows: ''The requirements of this paragraph are met with respect to an issue if the issuer reasonably expects that as of the close of the 3-year period beginning on the date of issuance of the issue, at least 95 percent of the net proceeds of the issue (as of the close of such period) will have been used directly or indirectly to make or finance loans to ultimate borrowers.''

Subsec. (f)(4) to (6). Pub. L. 109–222, §508(b), added pars. (4) and (5) and redesignated former par. (4) as (6). Former par. (5) redesignated (7).

Subsec. (f)(7). Pub. L. 109–222, §508(b), redesignated par. (5) as (7).

Subsec. (f)(7)(B). Pub. L. 109–222, §508(d)(2), substituted ''paragraph (6)(A)'' for ''paragraph (4)(A)''.

1996—Subsec. (g)(3)(B)(iii). Pub. L. 104–188 amended cl. (iii) generally. Prior to amendment, cl. (iii) read as follows: ''INVESTMENT EARNINGS HELD PENDING REINVESTMENT.—Investment earnings held for not more than 30 days pending reinvestment shall be treated as invested in bonds described in clause (i).''

1989—Subsec. (g). Pub. L. 101–239 added subsec. (g).

1988—Subsec. (b)(3)(A)(iii). Pub. L. 100–647, §1013(a)(20), struck out ''with respect to any bond issued before July 1, 1989'' after ''1984''.

Subsec. (b)(4)(A). Pub. L. 100–647, §1013(a)(21), substituted ''and a qualified student loan bond'' for ''a qualified student loan bond, and a qualified redevelopment bond''.

Subsec. (e)(3). Pub. L. 100–647, §1013(a)(22), substituted ''the failure to file in a timely fashion is not due to willful neglect'' for ''there is reasonable cause for the failure to file such statement in a timely fashion''.

Subsec. (f). Pub. L. 100–647, §5051(a), added subsec. (f).

CHANGE OF NAME

Reference to Veterans' Administration deemed to refer to Department of Veterans Affairs pursuant to section 10 of Pub. L. 100–527, set out as a Department of Veterans Affairs Act note under section 301 of Title 38, Veterans' Benefits.

EFFECTIVE DATE OF 2008 AMENDMENT

Pub. L. 110–289, div. C, title I, §3023(c), July 30, 2008, 122 Stat. 2895, provided that: ''The amendments made by this section [amending this section] shall apply to guarantees made after the date of the enactment of this Act [July 30, 2008].''

EFFECTIVE DATE OF 2006 AMENDMENT

Amendment by Pub. L. 109–222 applicable to bonds issued after May 17, 2006, see section 508(e) of Pub. L. 109–222, set out as a note under section 54 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Section 1704(b)(2) of Pub. L. 104–188 provided that: ''The amendment made by paragraph (1) [amending this section] shall take effect as if included in the amendments made by section 7651 of the Omnibus Budget Reconciliation Act of 1989 [Pub. L. 101–239].''

EFFECTIVE DATE OF 1989 AMENDMENT

Section 7651(b) of Pub. L. 101–239 provided that:

''(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendment made by subsection (a) [amending this section] shall apply to bonds issued after September 14, 1989.

''(2) BONDS SOLD BEFORE SEPTEMBER 15, 1989.—The amendment made by subsection (a) shall not apply to any bond sold before September 15, 1989, and issued before October 15, 1989.

''(3) BONDS WITH RESPECT TO WHICH PRELIMINARY OFFERING MATERIALS MAILED.—The amendment made by subsection (a) shall not apply to any issue issued after the date of the enactment of this Act [Dec. 19, 1989] if

the preliminary offering materials with respect to such issue were mailed (or otherwise delivered) to members of the underwriting syndicate before September 15, 1989.

''(4) CERTAIN OTHER BONDS.—In the case of a bond issued before January 1, 1991, with respect to which official action was taken (or a series of official actions were taken), or other comparable preliminary approval was given, before November 18, 1989, demonstrating an intent to issue such bonds in a maximum specified amount for such issue or with a maximum specified amount of net proceeds of such issue, the issuer may elect to apply section 149(g)(2) of the Internal Revenue Code of 1986 (as added by this section) by substituting '15 percent' for '10 percent' in subparagraph (A) and '50 percent' for '60 percent' in subparagraph (C).

''(5) BONDS ISSUED TO FINANCE SELF-INSURANCE FUNDS.—The amendment made by subsection (a) shall not apply to any bonds issued before July 1, 1990, to finance a self-insurance fund if official action was taken (or a series of official actions were taken), or other comparable preliminary approval was given, before September 15, 1989, demonstrating an intent to issue such bonds in a maximum specified amount for such issue or with a maximum specified amount of net proceeds of such issue.''

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by section 1013(a)(20)–(22) of Pub. L. 100–647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99–514, to which such amendment relates, see section 1019(a) of Pub. L. 100–647, set out as a note under section 1 of this title.

Section 5051(b) of Pub. L. 100–647 provided that:

''(1) IN GENERAL.—The amendment made by subsection (a) [amending this section] shall apply to bonds issued after October 21, 1988.

''(2) SPECIAL RULE FOR REFUNDING BONDS.—In the case of a bond issued to refund a bond issued before October 22, 1988—

''(A) if the 3-year period described in section 149(f)(2)(A) of the 1986 Code would (but for this paragraph) expire on or before October 22, 1989, such period shall expire on October 21, 1990, and

''(B) if such period expires after October 22, 1989, the portion of the proceeds of the issue of which the refunded bond is a part which is available (on the date of issuance of the refunding issue) to provide loans shall be treated as proceeds of a separate issue (issued after October 21, 1988) for purposes of applying section 149(f) of the 1986 Code.''

EFFECTIVE DATE

Subsec. (e) applicable to bonds issued after Dec. 31, 1986, see section 1311(d) of Pub. L. 99–514, as amended, set out as an Effective Date; Transitional Rules note under section 141 of this title.

TRANSFER OF FUNCTIONS

Federal Savings and Loan Insurance Corporation abolished and its functions transferred, see sections 401 to 406 of Pub. L. 101–73 set out as a note under section 1437 of Title 12, Banks and Banking.

SUBPART C—DEFINITIONS AND SPECIAL RULES

Sec.
150. Definitions and special rules.

§ 150. Definitions and special rules

(a) General rule

For purposes of this part—

(1) Bond

The term ''bond'' includes any obligation.

(2) Governmental unit not to include Federal Government

The term ''governmental unit'' does not include the United States or any agency or instrumentality thereof.

(3) Net proceeds

The term ''net proceeds'' means, with respect to any issue, the proceeds of such issue reduced by amounts in a reasonably required reserve or replacement fund.

(4) 501(c)(3) organization

The term ''501(c)(3) organization'' means any organization described in section 501(c)(3) and exempt from tax under section 501(a).

(5) Ownership of property

Property shall be treated as owned by a governmental unit if it is owned on behalf of such unit.

(6) Tax-exempt bond

The term ''tax-exempt'' means, with respect to any bond (or issue), that the interest on such bond (or on the bonds issued as part of such issue) is excluded from gross income.

(b) Change in use of facilities financed with tax-exempt private activity bonds

(1) Mortgage revenue bonds

(A) In general

In the case of any residence with respect to which financing is provided from the proceeds of a tax-exempt qualified mortgage bond or qualified veterans' mortgage bond, if there is a continuous period of at least 1 year during which such residence is not the principal residence of at least 1 of the mortgagors who received such financing, then no deduction shall be allowed under this chapter for interest on such financing which accrues on or after the date such period began and before the date such residence is again the principal residence of at least 1 of the mortgagors who received such financing.

(B) Exception

Subparagraph (A) shall not apply to the extent the Secretary determines that its application would result in undue hardship and that the failure to meet the requirements of subparagraph (A) resulted from circumstances beyond the mortgagor's control.

(2) Qualified residential rental projects

In the case of any project for residential rental property—

(A) with respect to which financing is provided from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt bond described in paragraph (7) of section 142(a), and

(B) which does not meet the requirements of section 142(d),

no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the 1st day of the taxable year in which such project fails to meet such requirements and ending on the date such project meets such requirements. If the provisions of prior law cor-