

Internal Revenue Service, Treasury

§ 1.148-0

§ 1.147-2 Remedial actions.

[T.D. 8712, 62 FR 2304, Jan. 16, 1997]

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

(a) *Overview.* Interest on a private activity bond is not excludable from gross income under section 103(a) unless the bond is a qualified bond. Under section 147, certain requirements must be met for a private activity bond to qualify as a qualified bond.

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

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

[T.D. 8712, 62 FR 2304, Jan. 16, 1997]

§ 1.147-2 Remedial actions.

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

[T.D. 8712, 62 FR 2304, Jan. 16, 1997]

§ 1.147(b)-1 Bond maturity limitation-treatment of working capital.

Section 147(b) does not apply to proceeds of a private activity bond issue

used to finance working capital expenditures.

[T.D. 8476, 58 FR 33515, June 18, 1993]

§ 1.148-0 Scope and table of contents.

(a) *Overview.* Under section 103(a), interest on certain obligations issued by States and local governments is excludable from the gross income of the owners. Section 148 was enacted to minimize the arbitrage benefits from investing gross proceeds of tax-exempt bonds in higher yielding investments and to remove the arbitrage incentives to issue more bonds, to issue bonds earlier, or to leave bonds outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes for which the bonds were issued. To accomplish these purposes, section 148 restricts the direct and indirect investment of bond proceeds in higher yielding investments and requires that certain earnings on higher yielding investments be rebated to the United States. Violation of these provisions causes the bonds in the issue to become *arbitrage bonds*, the interest on which is not excludable from the gross income of the owners under section 103(a). The regulations in §§ 1.148-1 through 1.148-11 apply in a manner consistent with these purposes.

(b) *Scope.* Sections 1.148-1 through 1.148-11 apply generally for purposes of the arbitrage restrictions on State and local bonds under section 148.

(c) *Table of contents.* This paragraph (c) lists the table of contents for §§ 1.148-1, 1.148-2, 1.148-3, 1.148-4, 1.148-5, 1.148-6, 1.148-7, 1.148-8, 1.148-9, 1.148-10 and 1.148-11.

§ 1.148-1 Definitions and elections.

- (a) In general.
- (b) Certain definitions.
- (c) Definition of replacement proceeds.
 - (1) In general.
 - (2) Sinking fund.
 - (3) Pledged fund.
 - (4) Other replacement proceeds.
- (d) Elections.
- (e) Investment-type property.
 - (1) In general.
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§ 1.148-2 General arbitrage yield restriction rules.

- (a) In general.
- (b) Reasonable expectations.
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- (2) Certification of expectations.
- (c) Intentional acts.
- (d) Materially higher yielding investments.
 - (1) In general.
- (2) Definitions of materially higher yield.
- (3) Mortgage loans.
- (e) Temporary periods.
 - (1) In general.
 - (2) General 3-year temporary period for capital projects and qualified mortgage loans.
 - (3) Temporary period for restricted working capital expenditures.
 - (4) Temporary period for pooled financings.
 - (5) Temporary period for replacement proceeds.
 - (6) Temporary period for investment proceeds.
 - (7) Other amounts.
- (f) Reserve or replacement funds.
 - (1) General 10 percent limitation on funding with sale proceeds.
 - (2) Exception from yield restriction for reasonably required reserve or replacement funds.
 - (3) Certain parity reserve funds.
- (g) Minor portion.
- (h) Certain waivers permitted.

§ 1.148-3 General arbitrage rebate rules.

- (a) In general.
- (b) Definition of rebate amount.
- (c) Computation of future value of a payment or receipt.
 - (1) Payments and receipts.
 - (1) Definition of payments.
 - (2) Definition of receipts.
 - (3) Special rules for commingled funds.
- (e) Computation dates.
 - (1) In general.
 - (2) Final computation date.
 - (f) Amount of required rebate installment payment.
 - (1) Amount of interim rebate payments.
 - (2) Amount of final rebate payment.
 - (3) Future value of rebate payments.
 - (g) Time and manner of payment.
 - (h) Penalty in lieu of loss of tax exemption.
 - (1) In general.
 - (2) Interest on underpayments.
 - (3) Waivers of the penalty.
 - (4) Application to alternative penalty under § 1.148-7.
 - (i) Recovery of overpayment of rebate.
 - (1) In general.
 - (2) Limitations on recovery.
 - (j) Examples.
 - (k) Bona fide debt service fund exception.

§ 1.148-4 Yield on an issue of bonds.

- (a) In general.
- (b) Computing yield on a fixed yield issue.
 - (1) In general.
 - (2) Yield on certain fixed yield bonds subject to mandatory or contingent early redemption.
 - (3) Yield on certain fixed yield bonds subject to optional early redemption.

- (4) Yield recomputed upon transfer of certain rights associated with the bond.
- (5) Special aggregation rule treating certain bonds as a single fixed yield bond.
- (6) Examples.
- (c) Computing yield on a variable yield issue.
 - (1) In general.
 - (2) Payments on bonds included in yield for a computation period.
 - (3) Example.
 - (d) Conversion from variable yield issue to fixed yield issue.
 - (e) Value of bonds.
 - (1) Plain par bonds.
 - (2) Other bonds.
 - (f) Qualified guarantees.
 - (1) In general.
 - (2) Interest savings.
 - (3) Guarantee in substance.
 - (4) Reasonable charge.
 - (5) Guarantee of purpose investments.
 - (6) Allocation of qualified guarantee payments.
 - (7) Refund or reduction of guarantee payments.
 - (g) Yield on certain mortgage revenue and student loan bonds.
 - (h) Qualified hedging transactions.
 - (1) In general.
 - (2) Qualified hedge defined.
 - (3) Accounting for qualified hedges.
 - (4) Certain variable yield bonds treated as fixed yield bonds.
 - (5) Contracts entered into before issue date of hedged bond.
 - (6) Authority of the Commissioner.

§ 1.148-5 Yield and valuation of investments.

- (a) In general.
- (b) Yield on an investment.
 - (1) In general.
 - (2) Yield on a separate class of investments.
 - (3) Investments to be held beyond issue's maturity or beyond temporary period.
 - (4) Consistent redemption assumptions on purpose investments.
 - (5) Student loan special allowance payments included in yield.
- (c) Yield reduction payments to the United States.
 - (1) In general.
 - (2) Manner of payment.
 - (3) Applicability of special yield reduction rule.
 - (d) Value of investments.
 - (1) In general.
 - (2) Mandatory valuation of yield restricted investments at present value.
 - (3) Mandatory valuation of certain investments at fair market value.
 - (4) Special transition rule for transferred proceeds.
 - (5) Definition of present value of an investment.
 - (6) Definition of fair market value.
 - (e) Administrative costs of investments.

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- (1) In general.
- (2) Qualified administrative costs on non-purpose investments.
- (3) Qualified administrative costs on purpose investments.

§ 1.148-6 General allocation and accounting rules.

- (a) In general.
 - (1) Reasonable accounting methods required.
 - (2) Bona fide deviations from accounting method.
 - (b) Allocation of gross proceeds to an issue.
 - (1) One-issue rule and general ordering rules.
 - (2) Universal cap on value of nonpurpose investments allocated to an issue.
 - (c) Fair market value limit on allocations to nonpurpose investments.
 - (d) Allocation of gross proceeds to expenditures.
 - (1) Expenditures in general.
 - (2) Treatment of gross proceeds invested in purpose investments.
 - (3) Expenditures for working capital purposes.
 - (4) Expenditures for grants.
 - (5) Expenditures for reimbursement purposes.
 - (6) Expenditures of certain commingled investment proceeds of governmental issues.
 - (7) Payments to related parties.
 - (e) Special rules for commingled funds.
 - (1) In general.
 - (2) Investments held by a commingled fund.
 - (3) Certain expenditures involving a commingled fund.
 - (4) Fiscal periods.
 - (5) Unrealized gains and losses on investments of a commingled fund.
 - (6) Allocations of commingled funds serving as common reserve funds or sinking funds.

§ 1.148-7 Spending exceptions to the rebate requirement.

- (a) Scope of section.
 - (1) In general.
 - (2) Relationship of spending exceptions.
 - (3) Spending exceptions not mandatory.
 - (b) Rules applicable for all spending exceptions.
 - (1) Special transferred proceeds rules.
 - (2) Application of multipurpose issue rules.
 - (3) Expenditures for governmental purposes of the issue.
 - (4) De minimis rule.
 - (5) Special definition of reasonably required reserve or replacement fund.
 - (6) Pooled financing issue.
 - (c) 6-month exception.
 - (1) General rule.
 - (2) Additional period for certain bonds.
 - (3) Amounts not included in gross proceeds.
 - (4) Series of refundings.

- (d) 18-month exception.
 - (1) General rule.
 - (2) Extension for reasonable retainage.
 - (3) Gross proceeds.
 - (4) Application to multipurpose issues.
 - (e) 2-year exception.
 - (1) General rule.
 - (2) Extension for reasonable retainage.
 - (3) Definitions.
 - (f) Construction issue.
 - (1) Definition.
 - (2) Use of actual facts.
 - (3) Ownership requirement.
 - (g) Construction expenditures.
 - (1) Definition.
 - (2) Certain acquisitions under turnkey contracts treated as construction expenditures.
 - (3) Constructed personal property.
 - (4) Specially developed computer software.
 - (5) Examples.
 - (h) Reasonable retainage definition.
 - (i) Available construction proceeds.
 - (1) Definition in general.
 - (2) Earnings on a reasonably required reserve or replacement fund.
 - (3) Reasonable expectations test for future earnings.
 - (4) Issuance costs.
 - (5) One and one-half percent penalty in lieu of arbitrage rebate.
 - (6) Payments on purpose investments and repayments of grants.
 - (7) Examples.
 - (j) Election to treat portion of issue used for construction as separate issue.
 - (1) In general.
 - (2) Example.
 - (k) One and one-half percent penalty in lieu of arbitrage rebate.
 - (1) In general.
 - (2) Application to reasonable retainage.
 - (3) Coordination with rebate requirement.
 - (1) Termination of 1½ percent penalty.
 - (1) Termination after initial temporary period.
 - (2) Termination before end of initial temporary period.
 - (3) Application to reasonable retainage.
 - (4) Example.
 - (m) Payment of penalties.

§ 1.148-8 Small issuer exception to rebate requirement.

- (a) Scope.
- (b) General taxing powers.
- (c) Size limitation.
 - (1) In general.
 - (2) Aggregation rules.
 - (3) Certain refunding bonds not taken into account.
 - (d) Pooled financings.
 - (1) Treatment of pool issuer.
 - (2) Treatment of conduit borrowers.
 - (e) Refunding issues.
 - (1) In general.
 - (2) Multipurpose issues.

§ 1.148-9 Arbitrage rules for refunding issues.

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- (a) Scope of application.
 - (b) Transferred proceeds allocation rule.
 - (1) In general.
 - (2) Special definition of principal amount.
 - (3) Relation of transferred proceeds rule to universal cap rule.
 - (4) Limitation on multi-generational transfers.
 - (c) Special allocation rules for refunding issues.
 - (1) Allocations of investments.
 - (2) Allocations of mixed escrows to expenditures for principal, interest, and redemption prices on a prior issue.
 - (d) Temporary periods in refundings.
 - (1) In general.
 - (2) Types of temporary periods in refundings.
 - (e) Reasonably required reserve or replacement funds in refundings.
 - (f) Minor portions in refundings.
 - (g) Certain waivers permitted.
 - (h) Multipurpose issue allocations.
 - (1) Application of multipurpose issue allocation rules.
 - (2) Rules on allocations of multipurpose issues.
 - (3) Separate purposes of a multipurpose issue.
 - (4) Allocations of bonds of a multipurpose issue.
 - (5) Limitation on multi-generation allocations.
 - (i) Operating rules for separation of prior issues into refunded and unrefunded portions.
 - (1) In general.
 - (2) Allocations of proceeds and investments in a partial refunding.
 - (3) References to prior issue.
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- (a) Abusive arbitrage device.
 - (1) In general.
 - (2) Abusive arbitrage device defined.
 - (3) Exploitation of tax-exempt interest rates.
 - (4) Overburdening the tax-exempt market.
 - (b) Consequences of overburdening the tax-exempt bond market.
 - (1) In general.
 - (2) Application.
 - (c) Anti-abuse rules on excess gross proceeds of advance refunding issues.
 - (1) In general.
 - (2) Definition of excess gross proceeds.
 - (3) Special treatment of transferred proceeds.
 - (4) Special rule for crossover refundings.
 - (5) Special rule for gross refundings.
 - (d) Examples.
 - (e) Authority of the Commissioner to clearly reflect the economic substance of a transaction.
 - (f) Authority of the Commissioner to require an earlier date for payment of rebate.

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- (g) Authority of the Commissioner to waive regulatory limitations.

§ 1.148-11 Effective dates.

- (a) In general.
- (b) Elective retroactive application in whole.
 - (1) In general.
 - (2) No elective retroactive application for 18-month spending exception.
 - (3) No elective retroactive application for hedges of fixed rate issues.
 - (4) No elective retroactive application for safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.
- (c) Elective retroactive application of certain provisions.
 - (1) Retroactive application of overpayment recovery provisions.
 - (2) Certain allocations of multipurpose issues.
 - (3) Special limitation.
 - (d) Transition rule excepting certain state guarantee funds from the definition of replacement proceeds.
 - (1) Certain perpetual trust funds.
 - (2) Permanent University Fund.
 - (e) Transition rule regarding special allowance payments.
 - (f) Transition rule regarding applicability of yield reduction rule.
 - (g) Provisions applicable to certain bonds sold before effective date.
 - (h) Safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.
 - (i) Special rule for certain broker's commissions and similar fees.
 - (j) Certain prepayments.

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§ 1.148-1 Definitions and elections.

(a) *In general.* The definitions in this section and the definitions under section 150 apply for purposes of section 148 and §§ 1.148-1 through 1.148-11.

(b) *Certain definitions.* The following definitions apply:

Accounting method means both the overall method used to account for gross proceeds of an issue (e.g., the cash method or a modified accrual method) and the method used to account for or allocate any particular item within that overall accounting method (e.g., accounting for investments, expenditures, allocations to and