DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR part 1

[TD 8941]

RIN 1545–AX87

Obligations of States and Political Subdivisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary regulations that provide guidance to issuers of tax-exempt bonds for output facilities. This document also contains final regulations that provide guidance to certain nongovernmental persons that are engaged in the local furnishing of electric energy or gas using facilities financed with state or local government bonds. These regulations will affect issuers of tax-exempt bonds and nongovernmental persons engaged in the local furnishing of electric energy or gas after the effective date.

The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: *Effective Date:* These regulations are effective January 19, 2001.

Applicability Date: For dates of applicability, see §§ 1.141–15T, 1.142(f)(4)–1(g), and 1.150–5(b).

FOR FURTHER INFORMATION CONTACT: Rose M. Weber (202) 622–3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in this rule has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545– .

The collection of information in this regulation is in § 1.142(f)(4)–1. This information is required to enable the IRS to identify persons engaged in the local furnishing of electric energy or gas that use facilities financed with exempt facility bonds under section 142(a)(8) and that expand their service area in a manner inconsistent with the requirements of sections 142(a)(8) and (f) who have made an election to ensure that those bonds will continue to be treated as exempt facility bonds. The data collected will be used by the IRS as the mechanism for identifying bonds that will remain tax-exempt notwithstanding a service area expansion that is inconsistent with the requirements of sections 142(a)(8) and (f). The collection of information is mandatory. The likely respondents are business institutions.

Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S:O Washington, DC 20224. Comments on the collection of information should be received by March 19, 2001. Comments are specifically requested concerning:

Whether the collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Estimated total annual reporting burden is 15 hours.

Estimated average annual burden hours per respondent is 1 hour.

Estimated number of respondents is 15.

Estimated annual frequency of responses is on occasion.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document amends the Income Tax Regulations (26 CFR part 1) under section 141 by providing special rules for tax-exempt bonds issued for output facilities. This document also amends the Income Tax Regulations under section 142(f)(4) by providing rules to make the election provided in that section for nongovernmental persons engaged in local furnishing of electric energy or gas using facilities financed with tax-exempt bonds.

On January 22, 1998, temporary regulations (TD 8757) (the 1998 temporary regulations) were published in the **Federal Register** (63 FR 3256) to provide guidance under the Internal Revenue Code of 1986 regarding the application of the private activity bond tests under section 141(b)(1) and (2) to output contracts for output facilities; the application of the $15 million limit under section 141(b)(4) to output facility financings; the election provided in section 142(f)(4) for nongovernmental persons engaged in local furnishing of electric energy or gas using facilities financed with tax-exempt bonds; and the filing location for certain notices and elections. A notice of proposed rulemaking (REG–110965–97) cross-referencing the temporary regulations was published in the **Federal Register** on the same day (63 FR 3296). On April 28, 1998, the IRS held a public hearing on the proposed regulations. Written comments responding to the notice of proposed rulemaking were also received. After consideration of all the comments, the 1998 temporary regulations are revised by this Treasury decision. The new temporary regulations are referred to below as the ''revised regulations.'' The revisions are discussed below.

Explanation of Provisions

A. Section 1.141–7T Special Rules for Output Facilities

1. Benefits and Burdens Test—Transmission Contracts

Under the 1998 temporary regulations, an agreement to provide firm or priority transmission services is generally treated as a take or take or pay contract. Commentators suggested that firm or priority transmission contracts should not automatically be treated as take or take or pay contracts. They recommended that the same standards that apply to determine whether generation contracts result in private business use, including the requirements contract provisions, should also apply to transmission contracts. The revised regulations adopt this recommendation by deleting the provision that generally treats all contracts for firm or priority transmission service as take or take or pay contracts.

2. Retail Requirements Contracts

The 1998 temporary regulations provide that a retail requirements contract generally meets the benefits and burdens test to the extent it obligates the purchaser to make payments that are not contingent on the purchaser's output requirements. Commentators requested clarification regarding the application of this rule to reasonable contract damages and termination provisions. The revised regulations clarify that a retail requirements contract does not meet the benefits and burdens test by reason of (1) a provision that requires the purchaser to pay reasonable and customary damages (including liquidated damages) in the event of a default, or (2) a provision that permits the purchaser to pay a specified amount to terminate the contract while the purchaser has requirements, in each case if the amount of the payment is reasonably related to the purchaser's obligation to buy requirements that is discharged by the payment.

3. Output Contract Properly Characterized as a Lease

Under the 1998 temporary regulations, output contracts that provide the purchaser with specific rights to control the output of a facility or with other specific performance rights to the use of output of the facility are generally taken into account under the private business tests, even if the benefits and burdens test is not met. Commentators requested clarification of the scope of this rule.

The revised regulations amend the rule and clarify its application by specifying that an output contract that is properly characterized as a lease for federal income tax purposes is tested under §§ 1.141–3 and 1.141–4 to determine whether it is taken into account under the private business tests.

4. Special Rule for Facilities With Significant Unutilized Capacity

The 1998 temporary regulations provide that, if an issuer reasonably expects on the issue date that persons that are treated as private business users will purchase more than 30 percent of the actual output of the facility, the Commissioner may determine the number of units produced or to be produced by the facility in one year on a reasonable basis other than by reference to nameplate capacity, such as the average expected annual output of the facility. The revised regulations change the 30 percent threshold to 20 percent.

5. Special Rule for Facilities With a Limited Source of Supply

Under the 1998 temporary regulations, the available output of a facility that is constrained by a limited source of supply must be determined by reasonably taking those constraints into account. Commentators requested clarification of the meaning of limited source of supply. For example, they asked whether the term includes not only physical but also economic limitations.

The revised regulations clarify that a limited source of supply includes a physical limitation, such as the flow of water, but not an economic limitation, such as the cost of coal or gas.

6. Measurement of Private Business Use

The 1998 temporary regulations provide that, if an output contract results in private business use, the amount of such use generally is the capacity that must be reserved for the nongovernmental person under prudent reliability standards. Commentators stated that this provision is difficult to apply and may overstate the amount of private business use. They suggested that the amount of private business use should be the amount of output actually purchased under the contract.

The revised regulations provide that, if an output contract results in private business use, the amount of private business use generally is the amount of output purchased under the contract.

7. Exception for Small Purchases of Output

The 1998 temporary regulations provide that output contracts are not taken into account under the private business tests if the purchaser is not required to make a substantially certain payment in any year that is greater than 0.5 percent of the average annual debt service on an issue that finances the facility. Some commentators suggested that this provision should be amended to take into account average annual payments under a contract, rather than payments in any one year, and that the provision should apply based on all the outstanding bonds for the facility. Other commentators stated that the exception should be eliminated as inconsistent with a competitive electric industry.

The revised regulations provide that output contracts are not taken into account under the private business tests if the average annual payments under the contract that are substantially certain to be made do not exceed 0.5 percent of the average annual debt service on all outstanding tax-exempt bonds issued to finance the facility.

8. Exception for Short-Term Sales of Output

The 1998 temporary regulations provide that the exceptions for short-term use that apply to other types of arrangements under the general private activity bond rules in § 1.141–3 also apply to output contracts. Many commentators suggested that these exceptions may have limited practical application in the output context and recommended that they be expanded to permit contracts of a longer duration. These commentators stated that longer-term contracts are required in order to transfer substantial benefits of ownership and substantial burdens of debt service with respect to an output facility. Other commentators suggested that any sale of output by a municipal utility outside of its traditional service territory should result in private business use.

The revised regulations provide an exception under which an output contract with a nongovernmental person will not be taken into account under the private business tests if: (1) the term of the contract, including all renewal options, does not exceed one year; (2) the compensation under the contract is based on generally applicable and uniformly applied rates or represents a negotiated, fair market price; and (3) the facility is not financed for a principal purpose of serving that nongovernmental person.

9. Special Exception for Sales of Output Attributable to Excess Generating Capacity Resulting From Open Access

The 1998 temporary regulations contain an exception to private business use for certain output contracts if: (1) The contract term does not exceed three years; (2) the issuer does not utilize tax-exempt financing to increase the generating capacity of its system during the contract term; (3) the governmental owner offers non-discriminatory, open access transmission tariffs under certain rules of the Federal Energy Regulatory Commission (FERC) (or comparable provisions of state law pursuant to a plan approved by the FERC); (4) all of the output sold is attributable to excess capacity resulting from the offer of the open access tariffs; (5) the contract mitigates stranded costs attributable to the open access tariffs; and (6) any stranded costs recovered by the governmental owner are applied as promptly as is reasonably practical to redeem tax-exempt bonds in a manner consistent with § 1.141–12.

Comments were received regarding many of the above requirements. In particular, many commentators

suggested that the maximum contract term should be extended beyond three years. Some commentators recommended eliminating the prohibition on tax-exempt financing to increase capacity during the contract term. Others suggested that de minimis capacity increases should be permitted. Some commentators suggested that the requirement that a contract mitigate stranded costs should be eliminated because the purpose of that provision is accomplished by the requirement that all of the output sold be attributable to excess capacity from open access tariffs. Some commentators recommended deleting the reference to FERC approval of state open access plans because the FERC may not approve all such plans. Other commentators requested clarification regarding the amounts that an issuer must use to redeem bonds. Finally, some commentators recommended deleting the exception entirely.

The revised regulations retain the exception, with certain modifications. First, the revised exception permits tax-exempt financing during the contract term for property that does not increase the generating capacity of the issuer's system by more than three percent. Second, the amended exception deletes the reference to FERC approval of state open access plans. Third, the revised regulations remove the reference to stranded costs. Finally, the revised exception clarifies that the amounts that an issuer must use to redeem bonds consist of all payments that it receives under the contract, other than the portion of such payments that is properly allocable to the payment of ordinary and necessary expenses directly attributable to the operation and maintenance of the facility (as described in § 1.141–4(c)(2)(C)).

10. Special Exceptions for Transmission Facilities

The 1998 temporary regulations do not treat all use of transmission facilities pursuant to standard tariffs as general public use, but contain certain special exceptions to private business use of transmission facilities. Some commentators suggested that use of transmission facilities under standard tariffs should be treated as general public use, and therefore should never result in private business use. The revised regulations do not treat all use of transmission facilities pursuant to standard tariffs as general public use, but retain and modify the special exceptions, as discussed below.

The 1998 temporary regulations contain two special exceptions under which certain actions with respect to transmission facilities financed by an issue are not treated as deliberate actions under § 1.141–2(d). The first exception provides that the execution of a contract for the use of transmission facilities is not treated as a deliberate action if the contract is entered into in response to or in anticipation of a specific order by the FERC to wheel power under sections 211 and 212 of the Federal Power Act (16 U.S.C. 824j and 824k) (or a state regulatory authority under comparable provisions of state law pursuant to a plan approved by the FERC); the terms of the contract are bona fide and arm's-length; and the consideration paid is consistent with section 212(a) of the Federal Power Act.

Commentators suggested eliminating the requirement that orders of state regulatory authorities be undertaken pursuant to a FERC-approved state open access plan because FERC approval may not be required for all such plans. The revised regulations adopt this suggested change.

The second exception in the 1998 temporary regulations provides that an action is not treated as a deliberate action if it is taken to implement the offering of non-discriminatory, open access tariffs for the use of financed transmission facilities in a manner consistent with FERC rules, including the reciprocity conditions of FERC Order No. 888 (61 FR 21540, May 10, 1996). The exception also applies to orders and rules of state regulatory authorities pursuant to a plan approved by the FERC that are comparable to certain FERC orders and rules. The exception does not apply, however, to the sale, exchange, or other disposition of bond-financed transmission facilities to a nongovernmental person.

Commentators recommended that the exception be expanded to apply to open access tariffs that are offered under state law provisions that are comparable to FERC rules, regardless of whether those provisions are promulgated by a state regulatory authority or approved by the FERC. The revised regulations adopt this suggested change.

Commentators also requested clarification regarding the circumstances in which an independent system operator (ISO) may be treated as a private business user of transmission facilities. Some commentators suggested that the operation of transmission facilities by an ISO is a quasi-governmental function and thus should never constitute private business use. Some commentators requested clarification of whether the existing rules for management contracts under section 141 may be applied to arrangements for the operation of transmission facilities by an ISO.

The revised regulations do not provide that the operation of bond-financed transmission facilities by an ISO or other regional transmission organization (RTO) is disregarded under section 141. However, the existing rules for management contracts under section 141, including Revenue Procedure 97–13 (1997–1 C.B. 632), are applicable in determining whether an arrangement for the operation of transmission facilities by an ISO or other RTO results in private business use, including a determination of whether the arrangement is properly characterized as a lease for federal income tax purposes. Comments are requested on whether additional guidance is needed concerning the treatment under section 141 of arrangements for the operation of bond-financed transmission facilities by an ISO or other RTO.

The 1998 temporary regulations provide a special transition rule for bonds (other than advance refunding bonds) that refund bonds issued prior to July 9, 1996 (the effective date of FERC Order No. 888). Under this rule, an action taken or to be taken with respect to transmission facilities is not taken into account under the reasonable expectations test of § 1.141–2(d) if the action is described in one of the two special exceptions discussed above and the weighted average maturity of the refunding bonds does not exceed the remaining weighted average maturity of the prior bonds.

Commentators recommended that the July 9, 1996 date be changed to a date on or after February 23, 1998 (the effective date of the 1998 temporary regulations). The revised regulations change the cut-off date to February 23, 1998.

Under the 1998 temporary regulations, issuers may apply the special exceptions for transmission facilities to any bonds issued before the effective date of those regulations. However, issuers may not apply the exceptions to refunding bonds issued on or after the effective date, unless the refunding bonds are subject to the 1998 temporary regulations in their entirety. Commentators suggested that, in order to encourage open access, issuers should be permitted to apply the exceptions to refunding bonds that are not otherwise subject to the regulations. The revised regulations adopt this change.

11. Definition of Transmission Facilities

The 1998 temporary regulations define transmission facilities to include facilities that are necessary to provide

ancillary services required to be offered as part of open access transmission tariffs under FERC rules. Commentators stated that the inclusion of ancillary services within the general definition of transmission facilities creates unwarranted complexity. They recommended that facilities used for ancillary services be treated as transmission facilities only for purposes of the special exceptions for transmission facilities in the regulations. The revised regulations adopt this approach.

B. Section 1.141–8T $15 Million Limitation for Output Facilities

Under the 1998 temporary regulations, property that replaces existing property is treated as part of the same project as the replaced property unless, among other things, the bonds that finance the replaced property have a weighted average maturity that is not greater than 120 percent of the reasonably expected economic life of the replaced property.

One commentator noted that it is not common to allocate bonds that finance output facilities to the specific assets that comprise those facilities, and thus it may be difficult to determine whether this 120 percent requirement is met. The revised regulations amend this rule so that it applies to the entire output facility of which the replaced property is a part, rather than the specific asset being replaced.

C. Need for Temporary Regulations and Request for Public Comments

Congress passed the Energy Policy Act of 1992 to encourage restructuring of the electric power industry. Since that time, the FERC and many states have adopted policies to open up access to transmission facilities. Treasury and the IRS are aware that these initiatives are causing rapid changes in the electric power industry.

The 1998 temporary regulations were published in order to provide immediate guidance under section 141 regarding the effect on the tax-exempt status of bonds of certain restructuring transactions necessary for utilities to participate in a restructured electric utility industry. Treasury and the IRS are aware, however, that restructuring efforts are evolving and uncertain, and that new types of arrangements may be developed to implement restructuring.

Accordingly, the revised regulations are published in both temporary and proposed form in order to continue to provide guidance on which issuers can rely in evaluating their participation in open access regimes, while providing the opportunity for public comment with respect to developments in the electric power industry that have occurred since the publication of the 1998 temporary regulations. The revised regulations are published in temporary form with the expectation that the Treasury and the IRS will reexamine them in light of new developments within the next three years.

Comments are invited on whether further guidance is needed to address the new types of contractual arrangements that are arising in the electric power industry. In particular, comments are invited on whether additional guidance is needed to address the proper treatment under section 141 of output contracts for the use of transmission and distribution facilities under open access, and output contracts for ancillary services that are necessary to maintain the reliability of a transmission grid. Comments are also requested on the impact of FERC Order No. 2000 (65 FR 810, January 6, 2000) on tax-exempt bonds issued by public power systems, including whether additional guidance is needed regarding the proper treatment under section 141 of arrangements for the operation of bond-financed transmission facilities by an ISO or other RTO that satisfies the requirements of Order 2000.

Effective Dates

Sections 1.141–7T and 1.141–8T are applicable to bonds sold on or after January 19, 2001. Section 1.142(f)(4)–1 applies to elections made on or after January 19, 2001. Section 1.150–5 applies to notices and elections filed on or after January 19, 2001.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that the collection of information in these regulations will not have a significant impact on a substantial number of small entities. This certification is based upon the fact that in the years 1987 through 1997 a total of only 80 different state or local government issuers of exempt facility bonds issued under section 142(f) for facilities for the local furnishing of electric energy or gas filed information returns with the IRS under section 149(e). Further, an election under section 142(f)(4) is in no event required to be filed with the Internal Revenue Service more than once. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Bruce M. Serchuk, and Rose M. Weber, Office of Chief Counsel (Tax-exempt and Government Entities), Internal Revenue Service, and Stephen J. Watson, Office of Tax Legislative Counsel, Department of the Treasury. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.141–0 is amended by revising the entire entries for §§ 1.141–7T, 1.141–8T and 1.141–15T to read as follows:

§ 1.141–0 Table of contents.

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§ 1.141–7T Special Rules for Output Facilities (Temporary).

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(2) Benefits and burdens test.
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(f) Exceptions for certain contracts.
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(5) Special exceptions for transmission facilities.
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§ 1.141–8T $15 Million Limitation for Output Facilities (Temporary).

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(b) Definition of project.
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(2) Separate ownership.
(3) Generating property.
(4) Transmission.
(5) Subsequent improvements.
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§ 1.141–15T Effective Dates (Temporary).

(a) through (e) [Reserved].
(f) Effective dates for certain regulations relating to output facilities.
(1) General rule.
(2) Transition rule for requirement contracts.
(3) Elective application of 1998 temporary regulations.
(g) Refunding bonds.
(h) Permissive retroactive application.
(i) Permissive retroactive application of certain regulations pertaining to output contracts.

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Par. 3. Section 1.141–7T is revised to read as follows:

§ 1.141–7T Special Rules for Output Facilities (Temporary).

(a) *Overview.* This section provides special rules to determine whether arrangements for the purchase of output from an output facility cause an issue of bonds to meet the private business tests. For this purpose, unless otherwise stated, water facilities are treated as output facilities. Sections 1.141–3 and 1.141–4 generally apply to determine whether other types of arrangements for use of an output facility cause an issue to meet the private business tests.

(b) *Definitions.* For purposes of this section and § 1.141–8T, the following definitions and rules apply:

(1) *Available output.* The available output of a facility financed by an issue is determined by multiplying the number of units produced or to be produced by the facility in one year by the number of years in the measurement period of that facility for that issue.

(i) *Generating facilities.* The number of units produced or to be produced by a generating facility in one year is determined by reference to its nameplate capacity or the equivalent (or where there is no nameplate capacity or the equivalent, its maximum capacity), which is not reduced for reserves, maintenance or other unutilized capacity.

(ii) *Transmission and other output facilities*—(A) *In general.* For transmission, cogeneration, and other output facilities, available output must be measured in a reasonable manner to reflect capacity.

(B) *Electric transmission facilities.* Measurement of the available output of all or a portion of electric transmission facilities may be determined in a manner consistent with the reporting rules and requirements for transmission networks promulgated by the Federal Energy Regulatory Commission (FERC). For example, for a transmission network, the use of aggregate load and load share ratios in a manner consistent with the requirements of the FERC may be reasonable. In addition, depending on the facts and circumstances, measurement of the available output of transmission facilities using thermal capacity or transfer capacity may be reasonable.

(iii) *Special rule for facilities with significant unutilized capacity.* If an issuer reasonably expects on the issue date that persons that are treated as private business users will purchase more than 20 percent of the actual output of the facility financed with the issue, the Commissioner may determine the number of units produced or to be produced by the facility in one year on a reasonable basis other than by reference to nameplate capacity, such as the average expected annual output of the facility. For example, the Commissioner may determine the available output of a financed peaking electric generating unit by reference to the reasonably expected annual output of that unit if the issuer reasonably expects, on the issue date of bonds that finance the unit, that an investor-owned utility will purchase more than 20 percent of the actual output of the facility during the measurement period under a take or pay contract, even if the amount of output purchased is less than 10 percent of the available output determined by reference to nameplate capacity. The reasonably expected annual output of the generating facility must be consistent with the capacity reported for prudent reliability purposes.

(iv) *Special rule for facilities with a limited source of supply.* If a limited source of supply constrains the output of an output facility, the number of units produced or to be produced by the facility must be determined by reasonably taking into account those constraints. For this purpose, a limited source of supply shall include a physical limitation (for example, flow of water), but not an economic limitation (for example, cost of coal or gas). For example, the available output of a hydroelectric unit must be determined by reference to the reasonably expected annual flow of water through the unit.

(2) *Measurement period.* The measurement period of an output facility financed by an issue is determined under § 1.141–3(g).

(3) *Sale at wholesale.* For purposes of this section, a sale at wholesale means a sale of output to any person for resale.

(4) *Take contract and take or pay contract.* A *take contract* is an output contract under which a purchaser agrees to pay for the output under the contract if the output facility is capable of providing the output. A *take or pay contract* is an output contract under which a purchaser agrees to pay for the output under the contract, whether or not the output facility is capable of providing the output.

(5) *Transmission facilities*—(i) *In general. Transmission facilities* are facilities for the transmission or distribution of output.

(ii) *Special rule for ancillary services.* For purposes of paragraph (f)(5), transmission facilities include facilities necessary to provide ancillary services required to be offered as part of open access transmission tariffs under rules promulgated by the FERC under sections 205 and 206 of the Federal Power Act (16 U.S.C. 824d and 824e). Thus, if a facility also serves another function (for example, a facility that provides for operating reserves for transmission and also provides generation) an allocable portion of the facility is treated as a transmission facility for purposes of paragraph (f)(5) of this section.

(6) *Nonqualified amount.* The nonqualified amount with respect to an issue is determined under section 141(b)(8).

(c) *Output contracts*—(1) *General rule.* The purchase by a nongovernmental person of available output of an output facility (output contract) financed with the proceeds of an issue is taken into account under the private business tests if the purchase has the effect of transferring substantial benefits of owning the facility and substantial burdens of paying the debt service on

bonds used (directly or indirectly) to finance the facility (the benefits and burdens test). See paragraph (c)(5) of this section for the treatment of an output contract that is properly characterized as a lease for Federal income tax purposes. See paragraphs (d) and (e) of this section for rules regarding measuring the use of, and payments of debt service for, an output facility for determining whether the private business tests are met. See also § 1.141–8T for rules for when an issue that finances an output facility (other than a water facility) meets the private business tests because the nonqualified amount of the issue exceeds $15 million.

(2) *Benefits and burdens test*—(i) *Benefits of ownership.* An output contract transfers substantial benefits of owning a facility if the contract gives the purchaser (directly or indirectly) rights to capacity of the facility on a basis that is preferential to the rights of the general public.

(ii) *Burdens of paying debt service.* An output contract transfers substantial burdens of paying debt service on an issue to the extent that the issuer reasonably expects that it is substantially certain that payments will be made under the terms of the contract (disregarding default, insolvency, or other similar circumstances). For example, an output contract is treated as transferring burdens of paying debt service on an issue if payments must be made upon contract termination.

(iii) *Payments pursuant to pledged contract.* Payments made or to be made under the terms of an output contract that is pledged as security for an issue are taken into account under the private business tests even if the issuer reasonably expects that it is not substantially certain that payments will be made under the contract (disregarding default, insolvency, or other similar circumstances). For this purpose, an output contract is pledged as security only if the bond documents provide that the pledged contract cannot be substantially amended without the consent of bondholders or a trustee for the bondholders. This paragraph (c)(2)(iii) applies to pledges made on or after February 23, 1998, with respect to bonds that are subject to this section.

(3) *Take contract or take or pay contract.* The benefits and burdens test is met if a nongovernmental person agrees pursuant to a take contract or a take or pay contract to purchase available output of a facility.

(4) *Requirements contracts*—(i) *In general.* A requirements contract under which a nongovernmental person agrees to purchase all or part of its output requirements is taken into account under the private business tests only to the extent that, based on all the facts and circumstances, the contract meets the benefits and burdens test. See § 1.141–15T(f)(2) for special effective dates for the application of this paragraph (c)(4) to issues financing facilities subject to requirements contracts.

(ii) *Significant factors.* Significant factors that tend to establish that the benefits and burdens test is met under the rule set forth in paragraph (c)(4)(i) of this section include, but are not limited to—

(A) The purchaser's customer base has significant indicators of stability, such as large size, diverse composition, and a substantial residential component;

(B) The contract covers historical requirements of the purchaser, rather than only projected requirements that are in addition to historical requirements; and

(C) The purchaser agrees not to construct or acquire other power resources to meet the requirements covered by the contract.

(iii) *Special rule for retail requirements contracts.* In general, a requirements contract that is not a sale at wholesale (a *retail requirements contract*) does not meet the benefits and burdens test because the obligation to make payments on the contract is contingent on the output requirements of a single user. Such a requirements contract in general meets the benefits and burdens test, however, to the extent that it contains contractual terms that obligate the purchaser to make payments that are not contingent on the output requirements of the purchaser or that obligate the purchaser to have output requirements. For example, a requirements contract with an industrial purchaser meets the benefits and burdens test if the purchaser enters into additional contractual obligations with the issuer or another governmental unit not to cease operations. A retail requirements contract does not meet the benefits and burdens test by reason of a provision that requires the purchaser to pay reasonable and customary damages (including liquidated damages) in the event of a default, or a provision that permits the purchaser to pay a specified amount to terminate the contract while the purchaser has requirements, in each case if the amount of the payment is reasonably related to the purchaser's obligation to buy requirements that is discharged by the payment.

(5) *Output contract properly characterized as a lease.* Notwithstanding any other provision of this section, an output contract that is properly characterized as a lease for Federal income tax purposes shall be tested under the rules contained in §§ 1.141–3 and 1.141–4 to determine whether it is taken into account under the private business tests.

(d) *Measurement of private business use.* If an output contract results in private business use under this section, the amount of private business use generally is the amount of output purchased under the contract.

(e) *Measurement of private security or payment.* The measurement of payments made or to be made by nongovernmental persons under output contracts as a percent of the debt service of an issue is determined under the rules provided in § 1.141–4.

(f) *Exceptions for certain contracts*—(1) *Small purchases of output.* An output contract is not taken into account under the private business tests if the average annual payments under the contract that are substantially certain to be made under paragraph (c)(2)(ii) of this section do not exceed 0.5 percent of the average annual debt service on all outstanding tax-exempt bonds issued to finance the facility, determined as of the effective date of the contract.

(2) *Swapping and pooling arrangements.* An agreement that provides for swapping or pooling of output by one or more governmental persons and one or more nongovernmental persons does not result in private business use of the output facility owned by the governmental person to the extent that—

(i) The swapped output is reasonably expected to be approximately equal in value (determined over periods of one year or less); and

(ii) The purpose of the agreement is to enable each of the parties to satisfy different peak load demands, to accommodate temporary outages, to diversify supply, or to enhance reliability in accordance with prudent reliability standards.

(3) *Short-term output contracts.* An output contract with a nongovernmental person is not taken into account under the private business tests if—

(i) The term of the contract, including all renewal options, is not longer than 1 year;

(ii) The contract either is a negotiated, arm's-length arrangement that provides for compensation at fair market value, or is based on generally applicable and uniformly applied rates; and

(iii) The output facility is not financed for a principal purpose of providing that facility for use by that nongovernmental person.

(4) *Special 3-year exception for sales of output attributable to excess generating capacity resulting from participation in open access.* The purchase of output of an electric generating facility by a nongovernmental person is not treated as private business use if all of the following requirements are met:

(i) The term of the contract is not longer than 3 years, including all renewal options.

(ii) The issuer does not make expenditures to increase the generating capacity of its system during the term of the contract that are, or will be, financed with proceeds of tax-exempt bonds (other than expenditures for property that does not increase the generating capacity of the system by more than 3 percent).

(iii) The governmental owner offers non-discriminatory, open access transmission tariffs for use of its transmission system pursuant to rules promulgated by the FERC under sections 205 and 206 of the Federal Power Act (16 U.S.C. 824d and 824e) (or comparable provisions of state law).

(iv) All of the output sold under the contract is attributable to excess capacity resulting from the offer of the non-discriminatory, open access transmission tariffs referred to in paragraph (f)(5)(iii) of this section.

(v) All payments received by the governmental owner under the contract (other than the portion of such payments described in § 1.141–4(c)(2)(C)) are applied as promptly as is reasonably practical to redeem tax-exempt bonds that financed the output facility in a manner consistent with § 1.141–12.

(5) *Special exceptions for transmission facilities*—(i) *Mandated wheeling.* Entering into a contract for the use of transmission facilities financed by an issue is not treated as a deliberate action under § 1.141–2(d) if—

(A) The contract is entered into in response to (or in anticipation of) an order by the United States under sections 211 and 212 of the Federal Power Act (16 U.S.C. 824j and 824k) (or a state regulatory authority under comparable provisions of state law); and

(B) The terms of the contract are bona fide and arm's length, and the consideration paid is consistent with the provisions of section 212(a) of the Federal Power Act.

(ii) *Actions taken to implement non-discriminatory, open access.* An action is not treated as a deliberate action under § 1.141–2(d) if it is taken to implement the offering of non-discriminatory, open access tariffs for the use of transmission facilities financed by an issue in a manner consistent with rules promulgated by the FERC under sections 205 and 206 of the Federal Power Act (16 U.S.C. 824d and 824e) (or comparable provisions of state law). This paragraph (f)(5)(ii) does not apply, however, to the sale, exchange, or other disposition of transmission facilities to a nongovernmental person.

(iii) *Application of reasonable expectations test to certain current refunding bonds.* An action taken or to be taken with respect to transmission facilities refinanced by an issue is not taken into account under the reasonable expectations test of § 1.141–2(d) if—

(A) The action is described in paragraph (f)(5)(i) or (ii) of this section;

(B) The bonds of the issue are current refunding bonds that, directly or indirectly, refund bonds originally issued before February 23, 1998; and

(C) The weighted average maturity of the refunding bonds is not greater than the remaining weighted average maturity of those prior bonds.

(6) *Certain conduit parties disregarded.* A nongovernmental person acting solely as a conduit for the exchange of output among governmentally owned and operated utilities is disregarded in determining whether the private business tests are met with respect to financed facilities owned by a governmental person. Use of property by a power marketer in the trade or business of purchasing and reselling power, however, is taken into account under the private business tests.

(g) *Allocations of output facilities and systems*—(1) *Facts and circumstances analysis.* Whether output sold under an output contract is allocated to a particular facility (for example, a generating unit), to the entire system of the seller of that output (net of any uses of that system output allocated to a particular facility), or to a portion of a facility is based on all the facts and circumstances. Significant factors to be considered in determining the allocation of an output contract to financed property are the following:

(i) The extent to which it is physically possible to deliver output to or from a particular facility or system.

(ii) The terms of a contract relating to the delivery of output (such as delivery limitations and options or obligations to deliver power from additional sources).

(iii) Whether a contract is entered into as part of a common plan of financing for a facility.

(iv) The method of pricing output under the contract, such as the use of market rates rather than rates designed to pay debt service of tax-exempt bonds used to finance a particular facility.

(2) *Illustrations.* The following illustrate the factors set forth in paragraph (g)(1) of this section:

(i) *Physical possibility.* Output from a generating unit that is fed directly into a low voltage distribution system of the owner of that unit and that cannot physically leave that distribution system generally must be allocated to those receiving electricity through that distribution system. Output may be allocated without regard to physical limitations, however, if exchange or similar agreements provide output to a purchaser where, but for the exchange agreements, it would not be possible for the seller to provide output to that purchaser.

(ii) *Contract terms relating to performance.* A contract to provide a specified amount of electricity from a system, but only when at least that amount of electricity is being generated by a particular unit, is allocated to that unit. For example, a contract to buy 20 MW of system power with a right to take up to 40 percent of the actual output of a specific 50 MW facility whenever total system output is insufficient to meet all of the seller's obligations generally is allocated to the specific facility rather than to the system.

(iii) *Common plan of financing.* A contract entered into as part of a common plan of financing for a facility generally is allocated to the facility if debt service for the issue of bonds is reasonably expected to be paid, directly or indirectly, from payments substantially certain to be made under the contract (disregarding default, insolvency, or other similar circumstances).

(iv) *Pricing method.* Pricing based on the capital and generating costs of a particular turbine tends to indicate that output under the contract is properly allocated to that turbine.

(3) *Transmission contracts.* Whether use under an output contract for transmission is allocated to a particular facility or to a transmission network is based on all the facts and circumstances, in a manner similar to paragraphs (g)(1) and (2) of this section. In general, the method used to determine payments under a contract is a more significant contract term for this purpose than nominal contract path. In general, if reasonable and consistently applied, the determination of use of transmission facilities under an output contract may be based on a method used by third parties, such as reliability councils.

(4) *Allocation of payments.* Payments for output provided by an output facility financed with two or more sources of

funding are generally allocated under the rules in § 1.141–4(c).

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

Example 1. Joint ownership. Z, an investor-owned electric utility, and City H agree to construct an electric generating facility of a size sufficient to take advantage of the economies of scale. H will issue $50 million of its 24-year bonds, and Z will use $100 million of its funds for construction of a facility they will jointly own as tenants in common. Each of the participants will share in the ownership, output, and operating expenses of the facility in proportion to its contribution to the cost of the facility, that is, one-third by H and two-thirds by Z. H's bonds will be secured by H's ownership interest in the facility and by revenues to be derived from its share of the annual output of the facility. H will need only 50 percent of its share of the annual output of the facility during the first 20 years of operations. It agrees to sell 10 percent of its share of the annual output to Z for a period of 20 years pursuant to a contract under which Z agrees to take that power if available. The facility will begin operation, and Z will begin to receive power, 4 years after the H bonds are issued. The measurement period for the property financed by the issue is 20 years. H also will sell the remaining 40 percent of its share of the annual output to numerous other private utilities under contracts of one year or less that satisfy the exception under paragraph (f)(3) of this section. No other contracts will be executed obligating any person to purchase any specified amount of the power for any specified period of time. No person (other than Z) will make payments substantially certain to be made (disregarding default, insolvency, or other similar circumstances) under paragraph (c)(2) of this section that will result in a transfer of substantial burdens of paying debt service on bonds used directly or indirectly to provide H's share of the facilities. The bonds are not private activity bonds, because H's one-third interest in the facility is not treated as used by the other owners of the facility. Although 10 percent of H's share of the annual output of the facility will be used in the trade or business of Z, a nongovernmental person, under this section, that portion constitutes not more than 10 percent of the available output of H's ownership interest in the facility.

Example 2. Requirements contract treated as take contract. (i) City J issues 20-year bonds to acquire an electric generating facility having a reasonably expected economic life substantially greater than 20 years and a nameplate capacity of 100 MW. The available output of the facility under paragraph (b)(1) of this section is approximately 17,520,000 MWh (100 MW × 24 hours × 365 days × 20 years). On the issue date, J enters into a contract with T, an investor-owned utility, to provide T with all of its power requirements for a period of 10 years, commencing on the issue date. J reasonably expects that T will actually purchase an average of 30 MW over the 10-year period. Based on all of the facts and circumstances, including the size, diversity, and composition of T's customer base, J reasonably expects that it is substantially certain (disregarding default, insolvency, or other similar circumstances) that T will actually purchase only an average of 26 MW over the 10-year period. The contract is a requirements contract that must be taken into account under the private business tests pursuant to paragraph (c)(4) of this section because it provides T with substantial benefits of ownership (rights to capacity) and obligates T with substantial burdens of making payments that the issuer reasonably expects are substantially certain.

(ii) Under paragraph (d) of this section, the amount of reasonably expected private business use under this contract is approximately 15 percent (30 MW × 24 hours × 365 days × 10 years, or 2,628,000 MWh) of the available output. Accordingly, the issue meets the private business use test. J reasonably expects that the amount to be paid for an average of 26 MW of power (less the operation and maintenance costs directly attributable to generating that 26 MW of power), will be more than 10 percent of debt service on the issue on a present-value basis. The payment for 26 MW of power is an amount that J reasonably expects is substantially certain to be made under paragraph (c)(2) of this section. Accordingly, the issue meets the private security or payment test because J reasonably expects that it is substantially certain that payment of more than 10 percent of the debt service will be indirectly derived from payments by T. The bonds are private activity bonds under paragraph (c) of this section. Further, if 15 percent of the sale proceeds of the issue is greater than $15 million and the issue meets the private security or payment test with respect to the $15 million output limitation, the bonds are also private activity bonds under section 141(b)(4). See § 1.141–8T.

Example 3. Allocation of existing contracts to new facilities. Power Authority K, a political subdivision created by the legislature in State × to own and operate certain power generating facilities, sells all of the power from its existing facilities to four private utility systems under contracts executed in 1999, under which the four systems are required to take or pay for specified portions of the total power output until the year 2029. Existing facilities supply all of the present needs of the four utility systems, but their future power requirements are expected to increase substantially beyond the capacity of K's current generating system. K issues 20-year bonds in 2004 to construct a large generating facility. As part of the financing plan for the bonds, a fifth private utility system contracts with K to take or pay for 15 percent of the available output of the new facility. The balance of the output of the new facility will be available for sale as required, but initially it is not anticipated that there will be any need for that power. The revenues from the contract with the fifth private utility system will be sufficient to pay less than 10 percent of the debt service on the bonds (determined on a present value basis). The balance, which will exceed 10 percent of the debt service on the bonds, will be paid from revenues derived from the contracts with the four systems initially from sale of power produced by the old facilities. The output contracts with all the private utilities are allocated to K's entire generating system. See paragraphs (g)(1) and (2) of this section. Thus, the bonds meet the private business use test because more than 10 percent of the proceeds will be used in the trade or business of a nongovernmental person. In addition, the bonds meet the private security or payment test because payment of more than 10 percent of the debt service, pursuant to underlying arrangements, will be derived from payments in respect of property used for a private business use.

Example 4. Allocation to displaced resource. Municipal utility MU, a political subdivision, purchases all of the electricity required to meet the needs of its customers (1,000 MW) from B, an investor-owned utility that operates its own electric generating facilities, under a 50-year take or pay contract. MU does not anticipate that it will require additional electric resources, and any new resources would produce electricity at a higher cost to MU than its cost under its contract with B. Nevertheless, B encourages MU to construct a new generating plant sufficient to meet MU's requirements. MU issues obligations to construct facilities that will produce 1,000 MW of electricity. MU, B, and I, another investor-owned utility, enter into an agreement under which MU assigns to I its rights under MU's take or pay contract with B. Under this arrangement, I will pay MU, and MU will continue to pay B, for the 1,000 MW. I's payments to MU will at least equal the amounts required to pay debt service on MU's bonds. In addition, under paragraph (g)(1)(iii) of this section, the contract among MU, B, and I is entered into as part of a common plan of financing of the MU facilities. Under all the facts and circumstances, MU's assignment to I of its rights under the original take or pay contract is allocable to MU's new facilities under paragraph (g) of this section. Because I is a nongovernmental person, MU's bonds are private activity bonds.

Example 5. Transmission facilities transferred to regional transmission organization. (i) In 2001, the public utilities commission of State C adopts a plan for restructuring its electric power industry. The plan fosters competition by providing both wholesale and retail customers with non-discriminatory access to transmission facilities within the State. The plan provides that investor-owned utilities will transfer operating control over all of their transmission assets to a regional transmission organization (RTO), which is a nongovernmental person that will operate those combined assets as a single, state-wide system. Municipally-owned utilities are eligible for, but are not required to participate in, the open access system implemented by the RTO. The functions of the RTO include control of transmission access and pricing, scheduling transmission, control area operations, and settlements and billing. The RTO's compensation under its operating agreement with transmission owners is based on a share of net profits from operating the facilities. The restructuring plan is approved by the FERC pursuant to sections 205 and 206 of the Federal Power Act.

(ii) In 1994, City D had issued bonds to finance improvements to its transmission system. In 2001, D transfers operating control of its transmission system to the RTO pursuant to the restructuring plan. At the same time, D chooses to apply the private activity bond regulations of §§ 1.141–1 through 1.141–15 to the 1994 bonds. The operation of the financed facilities by the RTO results in private business use under § 1.141–3. Under the special exception in paragraph (f)(5) of this section, however, the transfer of control is not treated as a deliberate action. Accordingly, the transfer of control does not cause the 1994 bonds to meet the private activity bond tests.

Example 6. Current refunding. The facts are the same as in Example 5 of this paragraph (h), and in addition D issues bonds in 2003 to currently refund the 1994 bonds. The weighted average maturity of the 2003 bonds is not greater than the remaining weighted average maturity of the 1994 bonds. D chooses to apply the private activity bond regulations of §§ 1.141–1 through 1.141–15 to the refunding bonds. In general, reasonable expectations must be separately tested on the date that refunding bonds are issued under § 1.141–2(d). Under the special exception in paragraph (f)(5) of this section, however, the transfer of the financed facilities to the RTO need not be taken into account in applying the reasonable expectations test to the refunding bonds.

Par. 4. Section 1.141–8T is revised to read as follows:

§ 1.141–8T $15 million limitation for output facilities (temporary).

(a) *In general*—(1) *General rule.* Section 141(b)(4) provides a special private activity bond limitation (the $15 million output limitation) for issues 5 percent or more of the proceeds of which are to be used to finance output facilities (other than a facility for the furnishing of water). Under this rule, an issue consists of private activity bonds under the private business tests of section 141(b)(1) and (2) if the nonqualified amount with respect to output facilities financed by the proceeds of the issue exceeds $15 million. The $15 million output limitation applies in addition to the private business tests of section 141(b)(1) and (2). Under section 141(b)(4) and paragraph (a)(2) of this section, the $15 million output limitation is reduced in certain cases. Specifically, an issue meets the test in section 141(b)(4) if both of the following tests are met:

(i) More than $15 million of the proceeds of the issue to be used with respect to an output facility are to be used for a private business use. Investment proceeds are disregarded for this purpose if they are not allocated disproportionately to the private business use portion of the issue.

(ii) The payment of the principal of, or the interest on, more than $15 million of the sales proceeds of the portion of the issue used with respect to an output facility is (under the terms of the issue or any underlying arrangement) directly or indirectly—

(A) Secured by any interest in an output facility used or to be used for a private business use (or payments in respect of such an output facility); or

(B) To be derived from payments (whether or not to the issuer) in respect of an output facility used or to be used for a private business use.

(2) *Reduction in $15 million output limitation for outstanding issues*—(i) *General rule.* In determining whether an issue 5 percent or more of the proceeds of which are to be used with respect to an output facility consists of private activity bonds under the $15 million output limitation, the $15 million limitation on private business use and private security or payments is applied by taking into account the aggregate nonqualified amounts of any outstanding bonds of other issues 5 percent or more of the proceeds of which are or will be used with respect to that output facility or any other output facility that is part of the same project.

(ii) *Bonds taken into account.* For purposes of this paragraph (a)(2), in applying the $15 million output limitation to an issue (the later issue), a tax-exempt bond of another issue (the earlier issue) is taken into account if—

(A) That bond is outstanding on the issue date of the later issue;

(B) That bond will not be redeemed within 90 days of the issue date of the later issue in connection with the refunding of that bond by the later issue; and

(C) 5 percent or more of the sale proceeds of the earlier issue financed an output facility that is part of the same project as the output facility that is financed by 5 percent or more of the sale proceeds of the later issue.

(3) *Benefits and burdens test applicable*—(i) *In general.* In applying the $15 million output limitation, the benefits and burdens test of § 1.141–7T applies, except that ''$15 million'' is substituted for ''10 percent'', or ''5 percent'' as appropriate.

(ii) *Earlier issues for the project.* If bonds of an earlier issue are outstanding and must be taken into account under paragraph (a)(2) of this section, the nonqualified amount for that earlier issue is multiplied by a fraction, the numerator of which is the adjusted issue price of the earlier issue as of the issue date of the later issue, and the denominator of which is the issue price of the earlier issue. Pre-issuance accrued interest as defined in § 1.148–1(b) is disregarded for this purpose.

(b) *Definition of project*—(1) *General rule.* For purposes of paragraph (a)(2) of this section, *project* has the meaning provided in this paragraph. Facilities that are functionally related and subordinate to a project are treated as part of that same project. Facilities having different purposes or serving different customer bases are not ordinarily part of the same project. For example, the following are generally not part of the same project—

(i) Generation and transmission facilities;

(ii) Separate facilities designed to serve wholesale customers and retail customers; and

(iii) A peaking unit and a baseload unit.

(2) *Separate ownership.* Except as otherwise provided in this paragraph (b)(2), facilities that are not owned by the same person are not part of the same project. If different governmental persons act in concert to finance a project, however (for example as participants in a joint powers authority), their interests are aggregated with respect to that project to determine whether the $15 million output limitation is met. In the case of undivided ownership interests in a single output facility, property that is not owned by different persons is treated as separate projects only if the separate interests are financed—

(i) With bonds of different issuers; and

(ii) Without a principal purpose of avoiding the limitation in this section.

(3) *Generating property*—(i) *Property on same site.* In the case of generation and related facilities, *project* means property located at the same site.

(ii) *Special rule for generating units.* Separate generating units are not part of the same project if one unit is reasonably expected, on the issue date of each issue that finances the units, to be placed in service more than 3 years before the other. Common facilities or property that will be functionally related to more than one generating unit must be allocated on a reasonable basis. If a generating unit already is constructed or is under construction (the first unit) and bonds are to be issued to finance an additional generating unit (the second unit), all costs for any common facilities paid or incurred before the earlier of the issue date of bonds to finance the second unit or the commencement of construction of the second unit are allocated to the first unit. At the time that bonds are issued to finance the second unit (or, if earlier, upon commencement of construction of

that unit), any remaining costs of the common facilities may be allocated between the first and second units so that in the aggregate the allocation is reasonable.

(4) *Transmission.* In the case of transmission facilities, *project* means functionally related or contiguous property. Separate transmission facilities are not part of the same project if one facility is reasonably expected, on the issue date of each issue that finances the facilities, to be placed in service more than 2 years before the other.

(5) *Subsequent improvements*—(i) *In general.* An improvement to generating or transmission facilities that is not part of the original design of those facilities (the original project) is not part of the same project as the original project if the construction, reconstruction, or acquisition of that improvement commences more than 3 years after the original project was placed in service and the bonds issued to finance that improvement are issued more than 3 years after the original project was placed in service.

(ii) *Special rule for transmission facilities.* An improvement to transmission facilities that is not part of the original design of that property is not part of the same project as the original project if the issuer did not reasonably expect the need to make that improvement when it commenced construction of the original project and the construction, reconstruction, or acquisition of that improvement is mandated by the federal government or a state regulatory authority to accommodate requests for wheeling.

(6) *Replacement property.* For purposes of this section, property that replaces existing property of an output facility is treated as part of the same project as the replaced property unless—

(i) The need to replace the property was not reasonably expected on the issue date or the need to replace the property occurred more than 3 years before the issuer reasonably expected (determined on the issue date of the bonds financing the property) that it would need to replace the property; and

(ii) The bonds that finance (and refinance) the output facility have a weighted average maturity that is not greater than 120 percent of the reasonably expected economic life of the facility.

(c) *Example.* The application of the provisions of this section is illustrated by the following example:

Example. (i) Power Authority K, a political subdivision, intends to issue a single issue of tax-exempt bonds at par with a stated principal amount and sale proceeds of $500 million to finance the acquisition of an electric generating facility. No portion of the facility will be used for a private business use, except that L, an investor-owned utility, will purchase 10 percent of the output of the facility under a take contract and will pay 10 percent of the debt service on the bonds. The nonqualified amount with respect to the bonds is $50 million.

(ii) The maximum amount of tax-exempt bonds that may be issued for the acquisition of an interest in the facility in paragraph (i) of this *Example* is $465 million (that is, $450 million for the 90 percent of the facility that is governmentally owned and used plus a nonqualified amount of $15 million).

Par. 5. Section 1.141–15 is amended by revising paragraphs (c), (d) and (e) to read as follows:

§ 1.141–15 Effective dates.

* * * * *

(c) *Refunding bonds.* Sections 1.141–1 through 1.141–6(a), 1.141–9 through 1.141–14, 1.145–1 through 1.145–2, 1.150–1(a)(3) and the definition of bond documents contained in § 1.150–1(b) do not apply to any bonds issued on or after May 16, 1997, to refund a bond to which those sections do not apply unless—

(1) The refunding bonds are subject to section 1301 of the Tax Reform Act of 1986 (100 Stat. 2602); and

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

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

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

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

(d) *Permissive application of regulations.* Except as provided in paragraph (e) of this section, §§ 1.141–1 through 1.141–6(a), 1.141–9 through 1.141–14, 1.145–1 through 1.145–2, 1.150–1(a)(3) and the definition of bond documents contained in § 1.150–1(b) may be applied in whole, but not in part, to actions taken before February 23, 1998, with respect to—

(1) Bonds that are outstanding on May 16, 1997, and subject to section 141; or

(2) Refunding bonds issued on or after May 16, 1997 that are subject to section 141.

(e) *Permissive application of certain sections.* The following sections may each be applied to any bonds—

(1) Section 1.141–3(b)(4);

(2) Section 1.141–3(b)(6); and

(3) Section 1.141–12.

Par. 6. Section 1.141–15T is revised to read as follows:

§ 1.141–15T Effective dates (temporary).

(a) through (e) [Reserved]. For further guidance see § 1.141–15.

(f) *Effective dates for certain regulations relating to output facilities*—(1) *General rule.* Except as otherwise provided in this section, §§ 1.141–7T and 1.141–8T apply to bonds sold on or after January 19, 2001, that are subject to section 1301 of the Tax Reform Act of 1986 (100 Stat. 2602).

(2) *Transition rule for requirements contracts.* For bonds otherwise subject to §§ 1.141–7T and 1.141–8T, § 1.141–7T(c)(4) applies to output contracts entered into on or after February 23, 1998. An output contract is treated as entered into on or after that date if its term is extended, the parties to the contract change, or other material terms are amended on or after that date. For purposes of this paragraph (f)(2)—

(i) The extension of the term of a contract causes the contract to be treated as entered into on the first day of the additional term;

(ii) The exercise by a party of a legally enforceable right that was provided under a contract before February 23, 1998, on terms that were fixed and determinable before such date, is not treated as an amendment of the contract. For example, the exercise by a purchaser after February 23, 1998 of a renewal option that was provided under a contract before that date, on terms identical to the original contract, is not treated as an amendment of the contract; and

(iii) An amendment that reduces the term of a contract, or the amount of requirements covered by a contract, is not, in and of itself, material.

(3) *Elective application of 1998 temporary regulations.* For an issue sold on or after January 19, 2001, and before February 15, 2001, an issuer may apply the provisions of §§ 1.141–7T and 1.141–8T in effect prior to January 19, 2001 (26 CFR part 1, revised April 1, 2000) in whole, but not in part, in lieu of applying §§ 1.141–7T and 1.141–8T.

(g) *Refunding bonds in general.* Except as otherwise provided in paragraph (h) or (i) of this section, §§ 1.141–7T and 1.141–8T do not apply to any bonds sold on or after January 19, 2001, to refund a bond to which §§ 1.141–7T and 1.141–8T do not apply unless—

(1) The refunding bonds are subject to section 1301 of the Tax Reform Act of 1986 (100 Stat. 2602); and

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

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

(B) In the case of a short-term obligation that the issuer reasonably

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

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

(h) *Permissive retroactive application.* Except as provided in § 1.141–15(d) or (e) or paragraph (i) of this section, §§ 1.141–1 through 1.141–6, 1.141–7T through 1.141–8T, 1.141–9 through 1.141–14, 1.145–1 through 1.145–2, 1.150–1(a)(3) and the definition of bond documents contained in § 1.150–1(b) may be applied in whole, but not in part to—

(1) Outstanding bonds that are sold before January 19, 2001, and subject to section 141; or

(2) Refunding bonds sold on or after January 19, 2001, that are subject to section 141.

(i) *Permissive application of certain regulations pertaining to output contracts.* Section 1.141–7T(f)(4) and (5) may be applied to any bonds.

Par. 7. Section 1.142(f)(4)–1 is added to read as follows:

§ 1.142(f)(4)–1 Manner of making election to terminate tax-exempt bond financing.

(a) *Overview.* Section 142(f)(4) permits a person engaged in the local furnishing of electric energy or gas (a local furnisher) that uses facilities financed with exempt facility bonds under section 142(a)(8) and that expands its service area in a manner inconsistent with the requirements of sections 142(a)(8) and (f) to make an election to ensure that those bonds will continue to be treated as exempt facility bonds. The election must meet the requirements of paragraphs (b) and (c) of this section.

(b) *Time for making election*—(1) *In general.* An election under section 142(f)(4)(B) must be filed with the Internal Revenue Service on or before 90 days after the date of the service area expansion that causes bonds to cease to meet the requirements of sections 142(a)(8) and (f).

(2) *Date of service area expansion.* For the purposes of this section, the date of the service area expansion is the first date on which the local furnisher is authorized to collect revenue for the provision of service in the expanded area.

(c) *Manner of making election.* An election under section 142(f)(4)(B) must be captioned ''ELECTION TO TERMINATE TAX-EXEMPT BOND FINANCING'', must be signed under penalties of perjury by a person who has authority to sign on behalf of the local furnisher, and must contain the following information—

(1) The name of the local furnisher;

(2) The tax identification number of the local furnisher;

(3) The complete address of the local furnisher;

(4) The date of the service area expansion;

(5) Identification of each bond issue subject to the election, including the complete name of each issue, the tax identification number of each issuer, the report number of the information return filed under section 149(e) for each issue, the issue date of each issue, the CUSIP number (if any) of the bond with the latest maturity of each issue, the issue price of each issue, the adjusted issue price of each issue as of the date of the election, the earliest date on which the bonds of each issue may be redeemed, and the principal amount of bonds of each issue to be redeemed on the earliest redemption date;

(6) A statement that the local furnisher making the election agrees to the conditions stated in section 142(f)(4)(B); and

(7) A statement that each issuer of the bonds subject to the election has received written notice of the election.

(d) *Effect on section 150(b).* Except as provided in paragraph (e) of this section, if a local furnisher files an election within the period specified in paragraph (b) of this section, section 150(b) does not apply to bonds identified in the election during and after that period.

(e) *Effect of failure to meet agreements.* If a local furnisher fails to meet any of the conditions stated in an election pursuant to paragraph (c)(6) of this section, the election is invalid.

(f) *Corresponding provisions of the Internal Revenue Code of 1954.* Section 103(b)(4)(E) of the Internal Revenue Code of 1954 set forth corresponding requirements for the exclusion from gross income of the interest on bonds issued for facilities for the local furnishing of electric energy or gas. For the purposes of this section any reference to sections 142(a)(8) and (f) of the Internal Revenue Code of 1986 includes a reference to the corresponding portion of section 103(b)(4)(E) of the Internal Revenue Code of 1954.

(g) *Effective dates.* This section applies to elections made on or after January 19, 2001.

§ 1.142(f)(4)–1T [Removed]

Par. 8. Section 1.142(f)(4)–1T is removed.

Par. 9. Section 1.150–5 is added to read as follows:

§ 1.150–5 Filing notices and elections.

(a) *In general.* Notices and elections under the following sections must be filed with the Internal Revenue Service, 1111 Constitution Avenue, NW, Attention: T:GE:TEB:O, Washington, DC 20224 or such other place designated by publication of a notice in the Internal Revenue Bulletin—

(1) Section 1.141–12(d)(3);

(2) Section 1.142(f)(4)-1; and

(3) Section 1.142–2(c)(2).

(b) *Effective dates.* This section applies to notices and elections filed on or after January 19, 2001.

§ 1.150–5T [Removed]

Par. 10. Section 1.150–5T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 11. The authority for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 12 . In § 602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.142(f)(4)–1	1545–1730
* * * * *	

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved: January 10, 2001.

Jonathan Talisman,

Assistant Secretary of the Treasury.

[FR Doc. 01–1412 filed 1–17–01; 8:45 am]

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DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 931

[NM–041–FOR]

New Mexico Regulatory Program

AGENCY: Office of Surface Mining Reclamation and Enforcement, Interior.

ACTION: Final rule, approval of amendment.

SUMMARY: The Office of Surface Mining Reclamation and Enforcement (OSM) is