

Notice of Proposed Rulemaking and Notice of Public Hearing

Obligations of States and Political Subdivisions

REG-113007-99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations on the definition of private activity bond applicable to tax-exempt bonds issued by state and local governments. These regulations affect issuers of tax-exempt bonds and provide needed guidance for applying the private activity bond restrictions to refunding issues. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by August 19, 2003. Outlines of topics to be discussed at the public hearing scheduled for September 9, 2003, at 10 a.m., must be received by August 19, 2003.

ADDRESSES: Send submissions to CC:PA:RU (REG-113007-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:RU (REG-113007-99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at www.irs.gov/regs. The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Gary W. Bornholdt, (202) 622-3980; concerning submissions and the hearing, Treena Garrett, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

In general, under section 103 of the Internal Revenue Code (Code), gross income does not include the interest on any state or local bond. However, this exclusion does not apply to private activity bonds (other than certain qualified bonds). Section 141(a) defines a private activity bond as any bond issued as part of an issue that meets either (1) the private business use test in section 141(b)(1) and the private security or payment test in section 141(b)(2) (the private business tests) or (2) the private loan financing test in section 141(c) (the private business tests and the private loan financing test are referred to collectively as the "private activity bond tests").

The private business use test is met if more than 10 percent of the proceeds of an issue are to be used for any private business use. Section 141(b)(6) defines private business use as use directly or indirectly in a trade or business that is carried on by any person other than a governmental unit.

The private security or payment test is met if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of an issue is directly or indirectly (1) secured by an interest in property used or to be used for a private business use, (2) secured by an interest in payments in respect of such property, or (3) to be derived from payments, whether or not to the issuer, in respect of property, or borrowed money, used or to be used for a private business use.

The private loan financing test is satisfied if more than the lesser of \$5 million or 5 percent of the proceeds of an issue are to be used to make or finance loans to persons other than governmental units.

In 1994, proposed regulations (FI-72-88, 1995-1 C.B. 859 [59 FR 67658]) were published in the **Federal Register** (the 1994 Proposed Regulations) to provide guidance under the Code with respect to the application of the private activity bond tests. Generally, the 1994 Proposed Regulations provide that the private business use of a facility is equal to the greatest percentage of private business use of that facility for any one year period during the term of the

bonds. The amount of private security or private payments is determined by comparing the present value of the private security or private payments to the present value of the debt service to be paid over the term of the issue, using the bond yield as the discount rate.

With respect to refunding issues, the 1994 Proposed Regulations provide that the determination of whether a refunding issue satisfies either the private business tests or the private loan financing test is made without regard to whether the prior issue satisfied those tests. In general, under the 1994 Proposed Regulations, the private business tests and the private loan financing test are applied to a refunding issue by treating the proceeds of the refunding issue as used for the same purposes as the proceeds of the prior issue, but disregarding any use of the property financed with the prior issue that occurred before the issue date of the refunding issue. In addition, in applying the private business tests to a refunding issue under the 1994 Proposed Regulations, an issuer may treat the refunding issue as a continuation of the prior issue.

On January 16, 1997, final regulations (T.D. 8712, 1997-1 C.B. 15 [62 FR 2275]) relating to the definition of private activity bond and related rules under sections 103, 141, 142, 144, 145, 147, 148, and 150 were published in the **Federal Register** (the Final Regulations). Under the Final Regulations, the amount of private business use of property financed by an issue is equal to the average percentage of private business use of that property during a defined measurement period. The measurement period begins on the later of the issue date of the issue or the date that the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the issue financing the property (determined without regard to any optional redemption dates). The Final Regulations retain the basic approach in the 1994 Proposed Regulations relating to the measurement of private security and private payments.

The Final Regulations reserve §1.141-13 for rules regarding the application of the private business tests and the private loan fi-

ancing test to refunding issues. This document amends the Income Tax Regulations (26 CFR part 1) under section 141 by proposing rules on the application of the private business tests and the private loan financing test to refunding issues. This document also amends the Income Tax Regulations under sections 145, 149, and 150 by proposing rules on certain related matters. These regulations are published as proposed regulations (the proposed regulations) to provide an opportunity for public review and comment.

Explanation of Provisions

A. Application of Private Activity Bond Tests to Refunding Issues

1. In general

The proposed regulations provide that, in general, a refunding issue and a prior issue are tested separately under section 141. Thus, the determination of whether a refunding issue consists of private activity bonds generally does not depend on whether the prior issue consists of private activity bonds.

The proposed regulations apply to determine whether a refunding issue satisfies the private business tests or the private loan financing test, but do not impact the methodology used to determine whether the prior issue satisfies those tests. For example, following a refunding, the private business use test continues to apply to a prior issue based on the measurement period for the prior issue.

2. Allocation of proceeds

The proposed regulations provide that, in applying the private business tests and the private loan financing test to a refunding issue, the proceeds of the refunding issue are allocated to the same purpose investments (including any private loan under section 141(c)) and expenditures as the proceeds of the prior issue.

3. Measurement of private business use

The proposed regulations generally provide that the amount of private business use of a refunding issue is determined based on the separate measurement period for the refunding issue under §1.141-3(g) (for example, without regard to any private business use that occurred before the is-

sue date of the refunding issue). Thus, for instance, if an issuer refunds a taxable bond or an exempt facility bond, any private business use of the refinanced facilities before the issue date of the refunding issue is disregarded in applying the private business use test to the refunding issue.

In the case of a refunding issue that refunds a prior issue of governmental bonds, however, the amount of private business use is generally determined based on a combined measurement period. For purposes of the proposed regulations, a governmental bond is any bond that, when issued, purported to be either a governmental bond, as defined in §1.150-1(b), or a qualified 501(c)(3) bond, as defined in section 145(a). The combined measurement period is the period that begins on the first day of the measurement period (as defined in §1.141-3(g)) for the prior issue (or the first issue of governmental bonds in the case of a series of refundings of governmental bonds) and ends on the last day of the measurement period for the refunding issue.

As an alternative to the combined measurement period approach, the proposed regulations permit issuers to measure private business use based on the separate measurement period of the refunding issue, but only if the prior issue of governmental bonds does not satisfy the private business use test during a shortened measurement period. The shortened measurement period begins on the first day of the measurement period of the prior issue (or the first issue of governmental bonds in the case of a series of refundings of governmental bonds) and ends on the issue date of the refunding issue. Whether a prior issue satisfies the private business use test during the shortened measurement period is determined based on the actual use of proceeds, without regard to the reasonable expectations test of §1.141-2(d).

4. Measurement of private security and private payments

If the amount of private business use is determined based on the separate measurement period for the refunding issue, then the amount of private security and private payments allocable to the refunding issue is determined under §1.141-4 by treating the refunding issue as a separate issue. On the other hand, if the amount of private business use is determined based on a combined measurement period, then the

amount of private security and private payments allocable to the refunding issue is determined under §1.141-4 by treating the refunding issue and all earlier issues taken into account in determining the combined measurement period as a combined issue. The proposed regulations contain specific rules for determining the present value of the debt service on, and the private security and private payments allocable to, a combined issue.

The proposed regulations also permit an issuer to use the yield on a prior issue of governmental bonds to determine the present value of private security or private payments under arrangements that were not entered into in contemplation of the refunding issue. For this purpose, any arrangement that was entered into more than one year before the issue date of the refunding issue will be treated as not entered into in contemplation of the refunding issue.

5. Multipurpose issue allocations

Section 1.148-9(h) permits an issuer to treat the portion of a multipurpose issue allocable to a separate purpose as a separate issue for certain of the arbitrage provisions of section 148. The proposed regulations allow an issuer to apply §1.148-9(h) to a multipurpose issue for certain purposes under section 141. An allocation will not be reasonable for this purpose if it achieves more favorable results under section 141 than could be achieved with actual separate issues. In addition, allocations under the proposed regulations and §1.148-9(h) must be consistent for purposes of sections 141 and 148. The proposed regulations do not permit allocations for purposes of section 141(c)(1) (relating to the private loan financing test) or section 141(d)(1) (relating to certain restrictions on acquiring non-governmental output property).

6. Application of reasonable expectations test to certain refunding bonds

Section 1.141-2(d) of the Final Regulations provides that an issue consists of private activity bonds if the issuer (1) reasonably expects, as of the issue date, that the issue will meet either the private business tests or the private loan financing test, or (2) takes a deliberate action, subsequent to the issue date, that causes the conditions of either the private business tests or the private loan financing test to be sat-

ified. In general, a deliberate action is any action taken by the issuer that is within its control.

The proposed regulations provide that an action that would otherwise cause a refunding issue to satisfy the private business tests or the private loan financing test is not taken into account under the reasonable expectations test of §1.141-2(d) if (1) the action is not a deliberate action within the meaning of §1.141-2(d)(3), and (2) the weighted average maturity of the refunding bonds is not greater than the remaining weighted average maturity of the prior bonds.

B. Treatment of Issuance Costs Financed by Prior Issue of Qualified 501(c)(3) Bonds

Under the Final Regulations, the use of proceeds of an issue of qualified 501(c)(3) bonds to pay issuance costs of the issue is treated as a private business use. The proposed regulations provide that, solely for purposes of applying the private business use test to a refunding issue, the use of proceeds of the prior issue (or any earlier issue in a series of refundings) to pay issuance costs of the prior issue (or the earlier issue) is treated as a government use.

C. Limitation on Advance Refundings of Private Activity Bonds

Under section 149(d)(2), interest on a bond is not excluded from gross income if any portion of the issue of which the bond is a part is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond). The proposed regulations provide that, for purposes of section 149(d)(2), the term private activity bond includes a qualified bond described in section 141(e) (other than a qualified 501(c)(3) bond), regardless of whether the refunding issue consists of private activity bonds under the proposed regulations. The proposed regulations also provide that, for purposes of section 149(d)(2), the term private activity bond does not include a taxable bond.

Proposed Effective Date

The proposed regulations will apply to bonds that are (1) sold on or after the date of publication of final regulations under §1.141-13 in the **Federal Register** and (2) subject to the Final Regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking 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, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments that are submitted timely (preferably a signed original and eight (8) copies) to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 9, 2003, at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the lobby more than 30 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments by August 19, 2003, and submit an outline of the topics to be discussed and the amount of time to be devoted to each topic by August 19, 2003.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Comments are requested on all aspects of the proposed regulations. In addition, comments are specifically requested on the application of the private loan financing test to refunding issues.

Drafting Information

The principal authors of these regulations are Bruce M. Serchuk and Gary W. Bornholdt, 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.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be 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 adding entries to the table in numerical order for §§1.141-13 and 1.141-15(j) to read as follows:

§1.141-0 Table of contents.

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§1.141-13 Refunding Issues.

- (a) In general.
- (b) Application of private business use test and private loan financing test.
 - (1) Allocation of proceeds.
 - (2) Determination of amount of private business use.
- (c) Application of private security or payment test.
 - (1) Separate issue treatment.
 - (2) Combined issue treatment.
 - (3) Special rule for arrangements not entered into in contemplation of the refunding issue.
- (d) Multipurpose issue allocations.
 - (1) In general.
 - (2) Exceptions.
- (e) Application of reasonable expectations test to certain refunding bonds.
- (f) Examples.

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§1.141-15 Effective dates.

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- (j) Effective dates for certain regulations relating to refundings.

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Par. 3. In §1.141–1, paragraph (b) is amended by revising the definition of governmental bond to read as follows:

§1.141–1 Definitions and rules of general application.

* * * * *

Governmental bond has the same meaning as in §1.150–1(b), except that, for purposes of §1.141–13, governmental bond is defined in §1.141–13(b)(2)(iv).

* * * * *

Par. 4. Section 1.141–13 is added to read as follows:

§1.141–13 Refunding Issues.

(a) *In general.* Except as provided in this section, a refunding issue and a prior issue are tested separately under section 141. Thus, the determination of whether a refunding issue consists of private activity bonds generally does not depend on whether the prior issue consists of private activity bonds.

(b) *Application of private business use test and private loan financing test—(1) Allocation of proceeds.* In applying the private business use test and the private loan financing test to a refunding issue, the proceeds of the refunding issue are allocated to the same expenditures and purpose investments as the proceeds of the prior issue.

(2) *Determination of amount of private business use—(i) In general.* Except as provided in paragraph (b)(2)(ii) of this section, the amount of private business use of a refunding issue is determined under §1.141–3(g), based on the measurement period for that issue (for example, without regard to any private business use that occurred prior to the issue date of the refunding issue).

(ii) *Refundings of governmental bonds.* In applying the private business use test to a refunding issue that refunds a prior issue of governmental bonds, the amount of private business use of the refunding issue is the amount of private business use—

(A) During the combined measurement period; or

(B) At the option of the issuer, during the period described in paragraph (b)(2)(i) of this section, but only if, without regard to the reasonable expectations test of §1.141–2(d), the prior issue does not satisfy the private business use test, based on a measurement period that begins on the

first day of the combined measurement period and ends on the issue date of the refunding issue.

(iii) *Combined measurement period.* For purposes of this section, the *combined measurement period* is the period that begins on the first day of the measurement period (as defined in §1.141–3(g)) for the prior issue (or, in the case of a series of refundings of governmental bonds, the first issue of governmental bonds in the series) and ends on the last day of the measurement period for the refunding issue.

(iv) *Governmental bond.* For purposes of this section, the term *governmental bond* means any bond that, when issued, purported to be a governmental bond, as defined in §1.150–1(b), or a qualified 501(c)(3) bond, as defined in section 145(a).

(v) *Special rule for refundings of qualified 501(c)(3) bonds with governmental bonds.* For purposes of applying this paragraph (b)(2) to a refunding issue that refunds a qualified 501(c)(3) bond, any use of the property refinanced by the refunding issue before the issue date of the refunding issue by a 501(c)(3) organization with respect to its activities that do not constitute an unrelated trade or business under section 513(a) is treated as government use.

(c) *Application of private security or payment test—(1) Separate issue treatment.* If the amount of private business use of a refunding issue is determined based on the measurement period for that issue in accordance with paragraph (b)(2)(i) or (b)(2)(ii)(B) of this section, then the amount of private security and private payments allocable to the refunding issue is determined under §1.141–4 by treating the refunding issue as a separate issue.

(2) *Combined issue treatment.* If the amount of private business use of a refunding issue is determined based on the combined measurement period for that issue in accordance with paragraph (b)(2)(ii)(A) of this section, then the amount of private security and private payments allocable to the refunding issue is determined under §1.141–4 by treating the refunding issue and all earlier issues taken into account in determining the combined measurement period as a combined issue. For this purpose, the present value of the private security and private payments is compared to the present value of the debt service on the combined issue (other than

debt service paid with proceeds of any refunding bond). Present values are computed as of the issue date of the earliest issue taken into account in determining the combined measurement period (the earliest issue). Except as provided in paragraph (c)(3) of this section, present values are determined by using the yield on the combined issue as the discount rate. The yield on the combined issue is determined by taking into account payments on the refunding issue and all earlier issues taken into account in determining the combined measurement period (other than payments made with proceeds of any refunding bond), and based on the issue price of the earliest issue. In the case of a partial refunding, the unrefunded debt service is not taken into account in determining the yield on the combined issue.

(3) *Special rule for arrangements not entered into in contemplation of the refunding issue.* In applying the private security or payment test to a refunding issue that refunds a prior issue of governmental bonds, the issuer may use the yield on the prior issue to determine the present value of private security and private payments under arrangements that were not entered into in contemplation of the refunding issue. For this purpose, any arrangement that was entered into more than 1 year before the issue date of the refunding issue is treated as not entered into in contemplation of the refunding issue.

(d) *Multipurpose issue allocations—(1) In general.* For purposes of section 141, unless the context clearly requires otherwise, §1.148–9(h) applies to allocations of multipurpose issues (as defined in §1.148–1(b)), including allocations involving the refunding purposes of the issue. An allocation is not reasonable under this paragraph (d) if it achieves more favorable results under section 141 than could be achieved with actual separate issues. Allocations made under this paragraph (d) and §1.148–9(h) must be consistent for purposes of section 141 and section 148.

(2) *Exceptions.* This paragraph (d) does not apply for purposes of sections 141(c)(1) and 141(d)(1).

(e) *Application of reasonable expectations test to certain refunding bonds.* An action that would otherwise cause a refunding issue to satisfy the private business tests or the private loan financing test is not taken

into account under the reasonable expectations test of §1.141-2(d) if—

(1) The action is not a deliberate action within the meaning of §1.141-2(d)(3); and

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

(f) Examples. The following examples illustrate the application of this section.

Example 1. Measuring private business use. In 2002, Authority A issues tax-exempt bonds that ma-

ture in 2032 to acquire an office building. The measurement period for the 2002 bonds under §1.141-3(g) is 30 years. At the time A acquires the building, it enters into a 10-year lease with a nongovernmental person under which the nongovernmental person will use 5 percent of the building in its trade or business during each year of the lease term. In 2007, A issues bonds to refund the 2002 bonds. The 2007 bonds mature on the same date as the 2002 bonds and have a measurement period of 25 years under §1.141-3(g). Under paragraph (b)(2)(ii)(A) of this section, the amount of private business use of the proceeds of the 2007 bonds is 1.67 percent, which equals the amount of private business use during the combined measurement period (5 percent of 1/3rd of the 30-year combined measurement period). In addition, the 2002

bonds do not satisfy the private business use test, based on a measurement period beginning on the first day of the measurement period for the 2002 bonds and ending on the issue date of the 2007 bonds, because only 5 percent of the proceeds of the 2002 bonds are used for a private business use during that period. Thus, under paragraph (b)(2)(ii)(B) of this section, A may treat the amount of private business use of the 2007 bonds as 1 percent (5 percent of 1/5th of the 25-year measurement period for the 2007 bonds). The 2007 bonds do not satisfy the private business use test.

Example 2. Combined issue yield computation. (i) On January 1, 2000, County B issues 20-year bonds with an interest rate of 8% and an issue price of \$100 million. The debt service payments on the 2000 bonds are as follows:

Date	Debt Service
1/1/01	\$10,306,800
1/1/02	10,306,800
1/1/03	10,306,800
1/1/04	10,306,800
1/1/05	10,306,800
1/1/06	10,306,800
1/1/07	10,306,800
1/1/08	10,306,800
1/1/09	10,306,800
1/1/10	10,306,800
1/1/11	10,306,800
1/1/12	10,306,800
1/1/13	10,306,800
1/1/14	10,306,800
1/1/15	10,306,800
1/1/16	10,306,800
1/1/17	10,306,800
1/1/18	10,306,800
1/1/19	10,306,800
1/1/20	10,306,800
	\$206,136,000

(ii) On January 1, 2005, B issues 15-year bonds to refund all of the outstanding 2000 bonds. The 2005 bonds have an interest rate of 6% and an issue price of \$93,250,000. The debt service payments on the 2005 bonds are as follows:

Date	Debt Service
1/1/06	\$9,657,800
1/1/07	9,657,800
1/1/08	9,657,800
1/1/09	9,657,800
1/1/10	9,657,800
1/1/11	9,657,800
1/1/12	9,657,800
1/1/13	9,657,800
1/1/14	9,657,800
1/1/15	9,657,800
1/1/16	9,657,800
1/1/17	9,657,800
1/1/18	9,657,800
1/1/19	9,657,800
1/1/20	9,657,800
	\$144,867,000

(iii) For purposes of determining the amount of private security and private payments with respect to the 2005 bonds, the 2005 bonds and the 2000 bonds are treated as a combined issue under paragraph (c)(2) of this section. The yield on the combined issue is 7.5036 percent per year compounded semiannually, computed as follows:

Date	Unrefunded New Money Debt Service	Refunding Debt Service	Total Debt Service	Present Value on 1/1/00
1/1/00				(\$100,000,000.00)
1/1/01	\$10,306,800		\$10,306,800	9,574,857.71
1/1/02	10,306,800		10,306,800	8,894,894.64
1/1/03	10,306,800		10,306,800	8,263,219.48
1/1/04	10,306,800		10,306,800	7,676,403.02
1/1/05	10,306,800		10,306,800	7,131,259.62
1/1/06		\$9,657,800	9,657,800	6,207,676.64
1/1/07		9,657,800	9,657,800	5,766,835.53
1/1/08		9,657,800	9,657,800	5,357,300.97
1/1/09		9,657,800	9,657,800	4,976,849.70
1/1/10		9,657,800	9,657,800	4,623,416.36
1/1/11		9,657,800	9,657,800	4,295,082.25
1/1/12		9,657,800	9,657,800	3,990,064.95
1/1/13		9,657,800	9,657,800	3,706,708.59
1/1/14		9,657,800	9,657,800	3,443,474.92
1/1/15		9,657,800	9,657,800	3,198,934.91
1/1/16		9,657,800	9,657,800	2,971,761.03
1/1/17		9,657,800	9,657,800	2,760,720.01
1/1/18		9,657,800	9,657,800	2,564,666.17
1/1/19		9,657,800	9,657,800	2,382,535.18
1/1/20		9,657,800	9,657,800	2,213,338.32
	\$51,534,000	\$144,867,000	\$196,401,000	0.00

Example 3. Refunding taxable bonds and qualified bonds. (i) In 1999, City C issues taxable bonds to finance the construction of a facility for the furnishing of water. The bonds are secured by revenues from the facility. The facility is managed pursuant to a management contract with a nongovernmental person that gives rise to private business use. In 2007, C terminates the management contract and takes over the operation of the facility. In 2009, C issues bonds to refund the 1999 bonds. On the issue date of the 2009 bonds, C reasonably expects that the facility will not be used for a private business use during the term of the 2009 bonds. In addition, during the term of the 2009 bonds, the facility is not used for a private business use. Under paragraph (b)(2)(i) of this section, the 2009 bonds do not satisfy the private business use test because the amount of private business use is based on the measurement period for those bonds and therefore does not take into account any private business use that occurred pursuant to the management contract.

(ii) The facts are the same as in paragraph (i) of this *Example 3*, except that the 1999 bonds are issued as exempt facility bonds under section 142(a)(4). The 2009 bonds do not satisfy the private business use test.

Example 4. Multipurpose issue. In 2001, State D issues bonds to finance the construction of two office buildings, Building 1 and Building 2. D expends an equal amount of the proceeds on each building. D enters into arrangements that result in 8 percent of Building 1 and 12 percent of Building 2 being used for a private business use during the mea-

surement period under §1.141-3(g). These arrangements result in a total of 10 percent of the proceeds of the 2001 bonds being used for a private business use. In 2006, D purports to allocate, under paragraph (d) of this section, an equal amount of the outstanding 2001 bonds to Building 1 and Building 2. D also enters into another private business use arrangement with respect to Building 1 that results in 10 percent of Building 1 being used for a private business use during the measurement period. An allocation is not reasonable under paragraph (d) of this section if it achieves more favorable results under section 141 than could be achieved with actual separate issues. D's allocation is unreasonable because, if permitted, would result in more than 10 percent of the proceeds of the 2001 bonds being used for a private business use.

Par. 5. Section 1.141-15 is amended by revising paragraphs (b)(1), (c), (d), and (h) and adding paragraph (j) to read as follows:

§1.141-15 Effective dates.

* * * * *

(b) *Effective dates*—(1) *In general.* Except as otherwise provided in this section, §§1.141-0 through 1.141-6(a), 1.141-9 through 1.141-12, 1.141-14, 1.145-1 through 1.145-2(c), and the definition of bond documents contained in §1.150-1(b) (the 1997 regulations contained in 26 CFR Part 1 revised April 1, 2003) apply to bonds

issued on or after May 16, 1997, that are subject to section 1301 of the Tax Reform Act of 1986 (100 Stat. 2602).

* * * * *

(c) *Refunding bonds.* Except as otherwise provided in this section, the 1997 regulations contained in 26 CFR Part 1 revised April 1, 2003, do not apply to any bonds issued on or after May 16, 1997, to refund a bond to which those regulations 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, the 1997 regulations contained in 26 CFR Part 1 revised April 1, 2003, 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 141.

* * * * *

(h) *Permissive retroactive application.* Except as provided in paragraphs (d), (e) or (i) of this section, §§1.141–1 through 1.141–6(a), 1.141–7 through 1.141–14, 1.145–1 through 1.145–2, 1.149(d)–1(g), 1.150–1(a)(3), the definition of bond documents contained in §1.150–1(b) and §1.150–1(c)(3)(ii) may be applied by issuers in whole, but not in part, to—

(1) Outstanding bonds that are sold before the date of publication of final regulations in the **Federal Register**, and subject to section 141; or

(2) Refunding bonds that are sold on or after the date of publication of final regulations in the **Federal Register**, and subject to section 141.

* * * * *

(j) *Effective dates for certain regulations relating to refundings.* Except as otherwise provided in this section, §§1.141–13, 1.145–2(d), 1.149(d)–1(g), 1.150–1(a)(3) and 1.150–1(c)(3)(ii) apply to bonds that are sold on or after the date of publication of final regulations in the **Federal Register** and that are subject to the 1997 regulations contained in 26 CFR Part 1 revised April 1, 2003.

Par. 6. Section 1.145–0 is amended by adding an entry to the table in numerical order for §1.145–2(d) to read as follows:

§1.145–0 Table of contents.

* * * * *

§1.145–2 Application of private activity bond regulations.

* * * * *

(d) Issuance costs financed by prior issue.

* * * * *

Par. 7. In §1.145–2, paragraph (d) is added to read as follows:

§1.145–2 Application of private activity bond regulations.

* * * * *

(d) *Issuance costs financed by prior issue.* Solely for purposes of applying the private business use test to a refunding issue under §1.141–13, the use of proceeds of the prior issue (or any earlier issue in a series of refundings) to pay issuance costs of the prior issue (or the earlier issue) is treated as a government use.

Par. 8. Section 1.149(d)–1 is amended by revising paragraph (g) and adding paragraph (h) to read as follows:

§1.149(d)–1 Limitations on advance refundings.

* * * * *

(g) *Limitation on advance refundings of private activity bonds.* Under section 149(d)(2) and this section, interest on a bond is not excluded from gross income if any portion of the issue of which the bond is a part is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond). For this purpose, the term private activity bond—

(1) Includes a qualified bond described in section 141(e) (other than a qualified 501(c)(3) bond), regardless of whether the refunding issue consists of private activity bonds under §1.141–13; and

(2) Does not include a taxable bond.

(h) *Effective dates—*(1) *In general.* Except as provided in this paragraph (h), this section applies to bonds issued after June 30, 1993, to which §§1.148–1 through 1.148–11 apply, including conduit loans that are treated as issued after June 30, 1993, under paragraph (b)(4) of this section. In addition, this section applies to any issue to which the election described in §1.148–11(b)(1) is made.

(2) *Special effective date for paragraph (b)(3).* Paragraph (b)(3) of this section applies to any advance refunding issue issued after May 28, 1991.

(3) *Special effective date for paragraph (f)(3).* Paragraph (f)(3) of this section applies to bonds sold on or after July 8, 1997, and to any issue to which the election described in §1.148–11(b)(1) is made. See §1.148–11A(i) for rules relating to certain bonds sold before July 8, 1997.

(4) *Special effective date for paragraph (g).* See §1.141–15 for the applicability date of paragraph (g) of this section.

Par. 9. Section 1.150–1 is amended by revising paragraphs (a)(3) and (c)(3)(ii) to read as follows:

§1.150–1 Definitions.

(a) * * *

(3) *Exceptions to general effective date.* See §1.141–15 for the applicability date of the definition of bond documents contained in paragraph (b) of this section and the effective date of paragraph (c)(3)(ii) of this section.

* * * * *

(c) * * *

(3) * * *

(ii) *Exceptions.* This paragraph (c)(3) does not apply for purposes of sections 141, 144(a), 148, 149(d) and 149(g).

* * * * *

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