Example 4. 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 1996, State A acquires the financed property in a condemnation action. In 2006, E issues bonds to refund the prior bonds (the refunding bonds). The weighted average maturity of the refunding bonds is not greater than the reasonably expected economic life of the financed property. In general, under §1.141–2(d) and this section, reasonable expectations must be separately tested on the issue date of a refunding issue. Under paragraph (e) of this section, however, the condemnation action is not taken into account in applying the reasonable expectations test to the refunding bonds because the condemnation action is not a deliberate action within the meaning of §1.141–2(d)(3) and the weighted average maturity of the refunding bonds is not greater than the weighted average reasonably expected economic life of the property financed by the prior bonds. Thus, the condemnation action does not cause the refunding bonds to be private activity bonds.


§ 1.141–14 Anti-abuse rules.

(a) Authority of Commissioner to reflect substance of transactions. If an issuer enters into a transaction or series of transactions with respect to one or more issues with a principal purpose of transferring to nongovernmental persons (other than as members of the general public) significant benefits of tax-exempt financing in a manner that is inconsistent with the purposes of section 141, the Commissioner may take any action to reflect the substance of the transaction or series of transactions, including—

(1) Treating separate issues as a single issue for purposes of the private activity bond tests;

(2) Reallocation proceeds to expenditures, property, use, or bonds;
(3) Reallocating payments to use or proceeds;
(4) Measuring private business use on a basis that reasonably reflects the economic benefit in a manner different than as provided in §1.141–3(g); and
(5) Measuring private payments or security on a basis that reasonably reflects the economic substance in a manner different than as provided in §1.141–4.

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

Example 1. Reallocating proceeds to indirect use. City C issues bonds with proceeds of $20 million for the stated purpose of financing improvements to roads that it owns. As a part of the same plan of financing, however, C also agrees to make a loan of $7 million to Corporation M from its general revenues that it otherwise would have used for the road improvements. The interest rate of the loan corresponds to the interest rate on a portion of the issue. A principal purpose of the financing arrangement is to transfer to M significant benefits of the tax-exempt financing. Although C actually allocates all of the proceeds of the bonds to the road improvements, the Commissioner may reallocate a portion of the proceeds of the bonds to the loan to M because a principal purpose of the financing arrangement is to transfer to M significant benefits of tax-exempt financing in a manner that is inconsistent with the purposes of section 141. The bonds are private activity bonds because the issue meets the private business tests, because only 10 percent of the proceeds are used in a trade or business by a nongovernmental person. A principal purpose of the issue is to transfer to G significant benefits of tax-exempt financing in a manner inconsistent with the purposes of section 141. The method of measuring private business use over the reasonably expected useful economic life of financed property is for the administrative convenience of issuers of state and local bonds. In cases where this method is used in a manner inconsistent with the purposes of section 141, the Commissioner may measure private business use on another basis that reasonably reflects economic benefit, such as in this case on an annual basis. If the Commissioner measures private business use on an annual basis, the bonds are private activity bonds because the private payment test is met and more than 10 percent of the proceeds are used in a trade or business by a nongovernmental person.

Example 2. Taking into account use of amounts derived from proceeds that would be otherwise disregarded. County B issues bonds with proceeds of $10 million to finance the purchase of land. On the issue date, B reasonably expects that it will be the sole user of the land. Subsequently, the federal government acquires the land for $3 million in a condemnation action. B uses this amount to make a loan to Corporation M. In addition, the interest rate on the loan reflects the tax-exempt interest rate on the bonds and thus is substantially less than a current market rate. A principal purpose of the arrangement is to transfer to M significant benefits of the tax-exempt financing. Although the condemnation action is not a deliberate action, the Commissioner may treat the condemnation proceeds as proceeds of the issue because a principal purpose of the arrangement is to transfer to M significant benefits of tax-exempt financing in a manner inconsistent with the purposes of section 141. The bonds are private activity bonds.

Example 3. Measuring private business use on an alternative basis. City F issues bonds with a 30-year term to finance the acquisition of an industrial building having a remaining reasonably expected useful economic life of more than 30 years. On the issue date, F leases the building to Corporation G for 3 years. F reasonably expects that it will be the sole user of the building for the remaining term of the bonds. Because of the local market conditions, it is reasonably expected that the fair rental value of the industrial building will be significantly greater during the early years of the term of the bonds than in the later years. The annual rental payments are significantly less than fair market value, reflecting the interest rate on the bonds. The present value of these rental payments (net of operation and maintenance expenses) as of the issue date, however, is approximately 25 percent of the present value of debt service on the issue. Under §1.141–3, the issue does not meet the private business tests, because only 10 percent of the proceeds are used in a trade or business by a nongovernmental person. A principal purpose of the issue is to transfer to G significant benefits of tax-exempt financing in a manner inconsistent with the purposes of section 141. The method of measuring private business use over the reasonably expected useful economic life of financed property is for the administrative convenience of issuers of state and local bonds. In cases where this method is used in a manner inconsistent with the purposes of section 141, the Commissioner may measure private business use on another basis that reasonably reflects economic benefit, such as in this case on an annual basis. If the Commissioner measures private business use on an annual basis, the bonds are private activity bonds because the private payment test is met and more than 10 percent of the proceeds are used in a trade or business by a nongovernmental person.

Example 4. Treating separate issues as a single issue. City D enters into a development agreement with Corporation T to induce T to locate its headquarters within D’s city limits. Pursuant to the development agreement, in 1997 D will issue $20 million of its general obligation bonds (the 1997 bonds) to purchase land that it will grant to T. The development agreement also provides that, in 1998, D will issue $20 million of its tax increment bonds (the 1998 bonds), secured solely by the increase in property taxes in a special taxing district. Substantially all of the property within the special taxing district is owned by T or D. T will separately enter into an agreement to guarantee the payment of tax increment to D in an amount sufficient to retire the 1998 bonds. The proceeds of the 1998 bonds will be used to finance improvements owned and operated by D that will not give rise to
private business use. Treated separately, the 1997 issue meets the private business use test, but not the private security or payment test; the 1998 issue meets the private security or payment test, but not the private business use test. A principal purpose of the financing plan, including the two issues, is to transfer significant benefits of tax-exempt financing to M in a manner inconsistent with the purposes of section 141.

Example 5, Reallocation proceeds. City E acquires an electric generating facility with a useful economic life of more than 40 years and enters into a 30-year take or pay contract to sell 30 percent of the available output to investor-owned utility M. E plans to use the remaining 70 percent of available output for its own governmental purposes. To finance the entire cost of the facility, E issues $30 million of its series A taxable bonds at taxable interest rates and $70 million series B bonds, which purport to be tax-exempt bonds, at tax-exempt interest rates. E transfers to M significant benefits of the tax-exempt interest income on a pro rata basis to both the series B bonds and all other operating costs. The allocation of all of M’s private business use to the proceeds of the series A bonds and all of its own government use to the proceeds of the series B bonds. The series A bonds have a weighted average maturity of 15 years, while the series B bonds have a weighted average maturity of 26 years. M’s payments under the take or pay contract are expressly determined by reference to 30 percent of M’s total costs (that is, the sum of the debt service and the series A and the series B bonds and all other operating costs). The allocation of all of M’s private business use to the series A bonds does not reflect economic substance because the series of transactions transfers to M significant benefits of the tax-exempt interest rates paid on the series B bonds. A principal purpose of the financing arrangement is to transfer to M significant benefits of the tax-exempt financing. Accordingly, the Commissioner may allocate M’s private business use to the series A bonds as well as the series A bonds, in which case the series B bonds are private activity bonds.

Example 6, Allocations respected. The facts are the same as in Example 5, except that the debt service component of M’s payments under the take or pay contract is based exclusively on fair market value pricing, rather than the tax-exempt interest rates on E’s bonds. The result also would be the same if the series A bonds and the series B bonds had substantially equivalent weighted average maturities and E and M had entered into a customary contract providing for payments based on a ratable share of total debt service. E would not be treated by the Commissioner in any of these cases as entering into the contract with a principal purpose of transferring the benefits of tax-exempt financing to M in a manner inconsistent with the purposes of section 141.


§ 1.141–15 Effective dates.

(a) Scope. The effective dates of this section apply for purposes of §§1.141–1 through 1.141–6(a), 1.141–7 through 1.141–14, 1.145–1 through 1.145–12, 1.150–1(a)(3) and the definition of bond documents contained in §1.150–1(b).

(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) 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).

(2) Certain short-term arrangements. The provisions of §1.141–3 that refer to arrangements for 200 days, 100 days, or 50 days apply to any bond sold on or after November 20, 2001 and may be applied to any bond outstanding on November 20, 2001 to which §1.141–3 applies.

(3) Certain prepayments. Except as provided in paragraph (c) of this section, paragraphs (c)(2)(i), (c)(2)(ii) and (c)(2)(iv) of §1.141–5 apply to bonds sold on or after October 3, 2003. Issuers may apply paragraphs (c)(2)(i), (c)(2)(ii) and (c)(2)(iv) of §1.141–5, in whole but not in part, to bonds sold before October 3, 2003 that are subject to §1.141–5.

(c) Refunding bonds. Except as otherwise provided in this section, the 1997 regulations (defined in paragraph (b)(1) of this section) 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