Example 6. Operation of transmission facilities by regional transmission organization. (i) Public utility MU is a political subdivision that owns and operates electric generation, transmission and distribution facilities. In 2003, MU issues bonds to finance improvements to its transmission and distribution facilities. In 2004, MU transfers operating control of its transmission system to the RTO, a nongovernmental organization. MU therefore recognizes that the RTO will be responsible for the operation and maintenance of MU's facilities. In addition, MU had issued bonds in 1994 to finance improvements to its generation facilities. The operation of MU's facilities, and the RTO's use of those facilities, does not result in private business use.

Example 7. Certain actions not treated as deliberate actions. The facts are the same as in Example 6 of this paragraph (i), except that the RTO's compensation is based on a share of net profits from the operation of MU's facilities, and the RTO does not bear any risk of loss of those facilities. Under this rule, the RTO does not result in private business use of MU's facilities.

Example 8. Current refunding. The facts are the same as in Example 7 of this paragraph (i), and in addition MU issues bonds in 2004 to currently refund the 1994 bonds. The weighted average maturity of the 2004 bonds is not greater than the remaining weighted average maturity of the 1994 bonds. MU 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 (g)(4)(iii) 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.
(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—(1) 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 non-qualified 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 §1.141–7 applies, except that “$15 million” is applied in place of “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. Preissuance 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, transmission and distribution facilities;

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

(iii) A peaking unit and a baseload unit (regardless of the location of the units).

(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
Internal Revenue Service, Treasury

§ 1.141–9

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 and distribution. In the case of transmission or distribution facilities, project means functionally related or contiguous property. Separate transmission or distribution 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—(1) In general. An improvement to generation, transmission or distribution 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 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 and distribution facilities. An improvement to transmission or distribution 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).

[T.D. 9016, 67 FR 59763, Sept. 23, 2002]

§ 1.141–9 Unrelated or disproportionate use test.

(a) General rules—(1) Description of test. Under section 141(b)(3) (the unrelated or disproportionate use test), an issue meets the private business tests if the amount of private business use and private security or payments attributable to unrelated or disproportionate private business use exceeds 5 percent of the proceeds of the issue. For this purpose, the private business use test is applied by taking into account only use that is not related to any government use of proceeds of the issue (unrelated use) and use that is related but disproportionate to any government use of those proceeds (disproportionate use).