DEPARTMENT OF AGRICULTURE

Rural Housing Service

Rural Business-Cooperative Service

Rural Utilities Service

Farm Service Agency

7 CFR Part 2003

Functional Organization of the Rural Development Mission Area; Correction

AGENCIES: Rural Housing Service; Rural Business-Cooperative Service; Rural Utilities Service; Farm Service Agency; USDA.

ACTION: Final rule; correcting amendments.

SUMMARY: This document contains corrections to the final regulations which were published Wednesday, December 24, 1997 (62 FR 67258–65). The regulations provided the function statements for organizational units within the Rural Development mission area, the Rural Housing Service, Rural Business-Cooperative Service, and the Rural Utilities Service.

EFFECTIVE DATE: January 22, 1998.

FOR FURTHER INFORMATION CONTACT: Timothy J. Ryan, Assistant Administrator for Human Resources, Rural Development, STOP 0730, 1400 Independence Avenue, SW., Washington, D.C. 20250–0730; Telephone: (202) 690–9860.

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections amend the issuing agencies regulations to reflect the reorganization of the Department of Agriculture. The Department of Agriculture Reorganization Act of 1994 (Pub. L. 103–354)(1994 Act), enacted on October 13, 1994, abolished the Farmers Home Administration (FmHA). The Office of the Assistant Administrator, Farm Loan Programs, and all of its subordinate organizational units have been transferred to the Farm Service Agency (FSA). The remainder of the FmHA organizational units have been transferred in accordance with the 1994 Act to one of the following newly created agencies which make up the Rural Development mission area (Rural Development): the Rural Housing Service, the Rural Business-Cooperative Service, and the Rural Utilities Service. The Rural Utilities Service also includes the organizational units of the former Rural Electrification Administration. The rule only covers the Rural Development agencies.

Need for Correction

As published, the final regulations contain errors which may cause inconvenience and confusion for the public.

List of Subjects in 7 CFR Part 2003

Organizations and functions (government agencies).

PART 2003—ORGANIZATION

Accordingly, 7 CFR part 2003 is corrected by making the following correcting amendments:

1. The authority citation for Part 2003 continues to read as follows:

Authority: 5 U.S.C. 301, 7 U.S.C. 901 *et seq.*, 7 U.S.C. 1989, 7 U.S.C. 6941 *et seq.*, 42 U.S.C. 1480 *et seq.*

§ 2003.10 [Corrected]

2. In the table in § 2003.10(c) the location for the USDA Rural Development State Office in Texas is revised to read ''Temple, TX''.

3. In the table in § 2003.10(c) after the entry for Texas, an additional State entry is added to read ''Utah'', and an additional location entry is added to read ''Salt Lake City, UT''.

Dated: January 14, 1998.

Jill Long Thompson,

Under Secretary, Rural Development.

[FR Doc. 98–1512 Filed 1–21–98; 8:45 am]

BILLING CODE 3410–XT–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8757]

RIN 1545–AV46

Obligations of States and Political Subdivisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations that provide guidance to state and local governments that issue bonds for output facilities. This document also contains temporary 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 temporary regulations reflect changes made by the Tax Reform Act of 1986 and the Small Business Job Protection Act of 1996. The temporary regulations will affect State and local government issuers of obligations and nongovernmental persons engaged in the local furnishing of electric energy or gas after the effective date of these regulations.

The text of these 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: These regulations are effective January 22, 1998.

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

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Allan Seller (202) 622–3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations (26 CFR part 1) under section 141 by providing special rules for state and local bonds issued for output facilities. This document also amends the Income Tax Regulations under section 142(f)(4) by providing rules for nongovernmental persons engaged in local furnishing of electric energy or gas using facilities financed with state or local bonds to make the election provided in that section. Proposed regulations §§ 1.141–7 and 1.141–8, published on December 30, 1994, (59 FR 67658) addressed the application of the private activity bond tests under section 141(b)(2) to output contracts for output facilities and the application of the $15 million limit under section 141(b)(4) to output facility financings. These sections (the 1994 proposed output regulations) are withdrawn. Public comments submitted on the 1994 proposed output regulations, however, have been taken into account in formulating these temporary regulations.

Explanation of Provisions

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

1. Basis for Special Rules for Output Facilities

The 1994 proposed output regulations contain special rules for applying the private business tests to output contracts. Among the reasons for special rules for output facilities are that governmentally-owned utilities are often under an open-ended obligation to assure service to their customers and that general public customers are ordinarily required to make continuing payments for service. Output facilities also require special rules because the

economic benefit provided by these facilities is usually the use of fungible property, such as electric power or water. The temporary regulations continue the approach of the proposed regulations, but contain a number of new provisions, consistent with the general principles of the existing regulations under § 1.103–7(b)(5), that take into account changes in the electric industry.

2. The Benefits and Burdens Standard

The 1994 proposed output regulations provide that a contract to sell output of a financed facility to a nongovernmental person may cause the private business tests of section 141(b) to be met if it has the effect of transferring to that nongovernmental person the benefits of owning the facility and the burdens of paying debt service on the facility. The temporary regulations adopt this standard, but clarify its application.

For purposes of the standard, the temporary regulations generally provide that use of output on a basis different from the general public has the effect of transferring the benefits of ownership. Similarly, contracts that provide a substantial certainty that payments for output will be made under the terms of the contract, other than on a short-term basis, have the effect of transferring the burden of paying debt service on a facility. The standard does not require that the burdens of ownership for general tax purposes be transferred to a nongovernmental person.

3. Requirements Contracts

The 1994 proposed output regulations provide that take or pay contracts, take contracts, and certain requirements contracts meet the benefits and burdens standard. Many commentators, noting that § 1.103–7(b)(5) does not expressly refer to requirements contracts, suggested that requirements contracts should never meet the benefits and burdens standard.

The temporary regulations narrow the rule for requirements contracts, by providing that a requirements contract meets the benefits and burdens test only to the extent that the issuer reasonably expects that it is substantially certain that payments for output will be made under the contract. Such a requirements contract is in substance equivalent to a take contract. A retail requirements contract generally does not meet this standard, unless the contract requires substantial termination payments or contains other terms that establish substantial certainty of payment. Whether the payments under a wholesale requirements contract are substantially certain to be made is determined on the basis of all the facts and circumstances, taking into account such factors as whether the purchaser's customer base has significant indicators of stability, whether the contract covers historical requirements of the purchaser, and whether the purchaser has agreed not to construct or acquire other power resources.

4. Special Rule for Output Contracts With Specific Performance Rights

The 1994 proposed output regulations provide that a requirements contract meets the benefits and burdens standard if the purchaser has priority rights to the output (or rights to control the allocation of the available output).

The temporary regulations generally provide that any output contract that provides the purchaser with specific rights to control the output or with other specific performance rights to the use of output of a financed facility meets the benefits and burdens test, even if the issuer reasonably expects that it is not substantially certain that payments will be made under the contract. This different standard applies to output contracts that provide the purchaser with specific performance rights because those contracts closely resemble leases, and, thus, provide more substantial rights to the use of a financed facility.

5. Security Interest Test

The 1994 proposed output regulations do not address how the security interest test applies to output contracts.

The temporary regulations provide that payments made or to be made under an output contract pledged as security for an issue are taken into account under the private security or payment test even if payment under the contract is not substantially certain. This rule is appropriate because it is reasonable to presume that payments under a contract pledged as security for an issue are material to the payment of debt service on an issue.

6. Use of Nameplate Capacity to Determine Available Output

The 1994 proposed output regulations measure the available output of a facility by reference to nameplate capacity, but further provide that, if nameplate capacity or its equivalent is greater than 150 percent of the average expected output, average expected output is used instead of nameplate capacity. In addition, nameplate capacity is reduced by scheduled maintenance. Commentators suggested that reference to nameplate capacity to determine available output is a bright-line, administrable test, and that the reductions to nameplate capacity in the 1994 proposed output regulations should be deleted.

The temporary regulations generally provide that nameplate capacity may be used as a reference to determine available output of a generating facility. This rule acknowledges that, consistent with prudent utility practice, governmentally-owned utilities may be required to acquire or construct facilities with excess capacity for their current or future reserves. To prevent tax-exempt financings that are inconsistent with the purposes of section 141, however, the temporary regulations provide that this rule does not apply if the issuer reasonably expects on the issue date that nongovernmental persons that are treated as private business users will purchase 30 percent or more of the actual output of the facility. In such a case, the Commissioner may determine available output on another reasonable basis. In addition, the temporary regulations clarify that, if a limited source of supply constrains the output of a facility (for example, if seasonal differences in water flow constrain output of a hydroelectric facility), the available output must be determined by taking into account these constraints. The temporary regulations also delete the rule that nameplate capacity is reduced by scheduled maintenance.

7. Exception for Swapping and Pooling Arrangements

The 1994 proposed output regulations provide that certain arrangements to swap and pool power do not meet the private business tests.

The temporary regulations simplify this exception and expand it, so that it includes swapping arrangements entered into to enhance reliability of a system.

8. Exceptions for Short-term Sales of Output

The 1994 proposed output regulations provide that 30-day agreements for spot sales of excess capacity do not result in private business use.

The 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. Thus, in general an output contract that is available to the general public may have a term up to 180 days; an output contract that is not treated as general public use, but that is offered on the basis of generally applicable or uniformly applied rates, may have a term of up to 90 days; and an output

contract that is specially negotiated may have a term of up to 30 days.

9. Special Exceptions for Sales of Output Attributable to Excess Generating Capacity Which Mitigate Stranded Costs

The 1994 proposed output regulations provide that a single nonrenewable contract for a term of not greater than 1 year is not treated as private business use. Commentators suggested that longer term, renewable contracts to sell output attributable to excess generating capacity should be disregarded under the private business use test. Commentators noted that the excess generating capacity problem may be exacerbated by the development of open-access regulatory policies and other factors.

The temporary regulations respond to these special considerations by providing a more flexible exception for sales of output attributable to excess generating capacity that results from the offering of nondiscriminatory, open access tariffs. This exception is also consistent with the Federal Energy Regulatory Commission policy that utilities should take reasonable steps to mitigate the imposition of charges to recover legitimate, prudent, and verifiable stranded costs associated with providing open access. Under this exception, a contract to sell excess power is not treated as private business use if the term of the contract (including all renewal options) is not greater than 3 years, the issuer does not issue tax-exempt bonds to increase the capacity of its generation system during the term of the contract, the governmental owner offers non-discriminatory, open access transmission tariffs pursuant to the FERC rules (or comparable state law provisions pursuant to a plan approved by the FERC), all of the output sold under the contract is excess capacity resulting from participation in open access, the contract mitigates stranded costs of the owner that are attributable to entry into the open access system, and stranded costs recovered under the contract by that owner are used to redeem tax-exempt bonds as promptly as reasonably practical.

10. Special Exceptions for Transmission Facilities

The 1994 proposed output regulations provide special rules for transmission facilities, which are intended to respond to the development of regulatory policies that require or encourage open access to transmission systems. Under these special rules, in general, the use of transmission facilities is not private business use to the extent that it results from an order or actions taken in response to (or to prevent) an anticipated order by the United States that those facilities be used by a particular nongovernmental person, provided that the transmission facilities were sized based on the issuer's reasonable expectations about the amount of wheeling. The 1994 proposed output regulations contain a number of exceptions to this rule, which are designed to prevent the tax-exempt financing of facilities constructed for use by nongovernmental persons. The 1994 proposed output regulations also provide that an issuer must take remedial action if more than 20 percent of a transmission facility is so used by a nongovernmental person.

Commentators suggested that the exceptions for use of transmission systems should be made more flexible to accommodate the development of open access regulatory policies. Commentators noted that measurement of use of a transmission system raises a number of complex technical issues. For example, capacity or available output may be much more readily determined for a generating unit than for a transmission system. Some commentators suggested that all use of a transmission system pursuant to standard tariffs should be treated as general public use. Other commentators suggested that any rules addressing open access required by the FERC should also similarly address open access required by state public utility commissions.

The temporary regulations broaden the exceptions for use of transmission facilities, but do not treat all use of transmission facilities pursuant to standard tariffs as general public use. Under § 1.141–2(d), an action taken in response to a specific FERC order to wheel power under sections 211 and 212 of the Federal Power Act (16 U.S.C. 824j and 824k) would otherwise qualify for an exception from the deliberate action rule because it is taken in response to a regulatory directive made by the federal government. The temporary regulations additionally provide that an action taken in anticipation of such an order is not a deliberate action.

The temporary regulations also provide a special exception for transmission facilities pursuant to which an action is not treated as a deliberate action if it is taken to implement the offering of non-discriminatory, open access for the use of financed transmission facilities in a manner consistent with FERC rules, including reciprocity conditions of FERC Order No. 888 (61 FR 21540, May 10, 1996), pursuant to a plan approved by the FERC. The special 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. This exception does not apply, however, to the sale, exchange, or other disposition of bond-financed transmission facilities to a nongovernmental person.

Section 1.141–2(d)(1) provides that an issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either the private business tests or the private loan financing test or if the issuer 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 met. Thus, reasonable expectations about private business use of transmission facilities under non-discriminatory, open-access tariffs, must be taken into account on the issue date of bonds financing those facilities. A special transition rule applies to bonds (other than advance refunding bonds) that refund bonds issued prior to July 9, 1996 (the effective date of FERC Order No. 888). Because an issuer is in general not required to apply the temporary regulations to refunding bonds issued after the effective date that do not have a weighted average maturity longer than the remaining weighted average maturity of the refunded bonds, the special transition rule will apply only if the issuer chooses to apply the temporary regulations. Whether bonds issued after July 9, 1996, to finance output facilities met the reasonable expectations test of section 141 because of the possibility of actions taken to implement open access tariffs is appropriately determined on a facts and circumstances basis.

These special rules for transmission facilities are appropriate because of the unique statutory and regulatory regime that applies to transmission facilities.

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

1. Clarification of Computation of Nonqualified Amount

The 1994 proposed output regulations provide guidance on the special $15 million limitation on output facilities of section 141(b)(4). In general, this limitation is based on the ''nonqualified amount'' of an issue or issues that finance a single project.

The temporary regulations clarify that, in determining the total nonqualified amount for issues

financing a project, the nonqualified amount is first determined on an issue-by-issue basis, and that these amounts are then aggregated. The temporary regulations also provide a simpler method for determining how much the nonqualified amount of an issue is reduced when principal of the issue is paid. Under this method, the nonqualified amount of an issue is reduced by the ratio of adjusted issue price over issue price.

C. Section 1.142(f)(4)–1T Manner of Making Election to Terminate Tax-exempt Bond Financing

Section 142(f)(4) permits a person engaged in the local furnishing of electric energy or gas 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 142(f) to make an election to ensure that those bonds will continue to be treated as exempt facility bonds. In order to make the election the person engaged in local furnishing must, among other things, agree to redeem all outstanding bonds that financed the facilities not later than 6 months after the later of the earliest date on which the bonds may be redeemed or the date of the election. The temporary regulations set forth the required time and manner of making this election. In general, the election must be made on or before the 90th day after the later of (i) the date of the service area expansion or (ii) the effective date of the temporary regulations.

D. § 1.150–5T Filing Notices and Elections

The temporary regulations specify that notices and elections under section 142(f)(4)(B) and § 1.141–12(d)(3) must be filed with the Chief, Employee Plans and Exempt Organizations Division of the appropriate key district office.

E. Need for Temporary Regulations and Request for Public Comments

Congress passed the Federal Energy Act of 1992 to encourage deregulation of the electric power industry. Since that time, the Federal Energy Regulatory Commission and various 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, and have received many comments asking for 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 deregulated electric utility environment. For example, several comments state that the restructuring initiatives in various states and regions may not proceed until Treasury and the IRS clarify the extent to which municipal utilities may transfer control of certain assets financed with tax-exempt bonds to an independent system operator. Based on these considerations, it has been determined that immediate regulatory guidance is necessary to ensure efficient administration of the tax laws.

The regulations are published in both temporary and proposed form to provide immediate guidance on which issuers can rely in evaluating their participation in open access regimes, while providing the opportunity for public comment. In addition, Treasury and the IRS believe that providing guidance on the effect of open access participation is more appropriately accomplished by regulation than by private letter ruling. Treasury and the IRS are also aware, however, that restructuring efforts are evolving and uncertain, and that new types of arrangements may be developed to implement restructuring. Many of the issues that will arise may need to be addressed legislatively. Accordingly, the regulations are published in temporary form with the expectation 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 there are any instances in which an option of a nongovernmental purchaser to purchase output of a bond-financed facility should not be taken into account as private business use.

Effective Dates

Sections 1.141–7T and 1.141–8T are applicable to bonds issued on or after February 23, 1998.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 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 provisions of these regulations that impose a collection of information requirement on small entities do 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 1993 a total of only 61 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 Internal Revenue Service 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 Michael G. Bailey and Allan Seller, Office of Assistant Chief Counsel (Financial Institutions & Products), and Nancy M. Lashnits, formerly of that office. However, other personnel from IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, 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 removing the entries for §§ 1.141–7 and 1.141–8 and adding entries to the table in numerical order to read as follows:

§ 1.141–0 Table of contents.

* * * * *

§ 1.141–7T Special rules for output facilities (temporary).

(a) Overview.
(b) Definitions.
(1) Available output.
(2) Measurement period.
(3) Sale at wholesale.
(4) Stranded costs.
(5) Take contract and take or pay contract.
(6) Transmission facilities.
(7) Nonqualified amount.
(c) Output contracts.

Par. 3. Section 1.141–2 is amended by adding a sentence at the end of paragraph (d)(3)(ii)(B) to read as follows:

§ 1.141–2 Private activity bond tests.

* * * * *
(d) * * *
(3) * * *
(ii) * * *
(B) * * * See § 1.141–7T(f)(5).
* * * * *

§§ 1.141–7 and 1.141–8 [Removed]

Par. 3a. Sections 1.141–7 and 1.141–8 are removed.

Par. 4. Sections 1.141–7T and 1.141–8T are added 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 purchases 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. Section 1.141–3 generally applies 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 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 acquired or constructed primarily for use by private business users*. 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 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 treat the reasonably expected annual output of a financed peaking electric generating unit as the available 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 30 percent of the actual output of the facility 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 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) *Stranded costs*. For purposes of this section, *stranded costs* means stranded costs as defined in 18 CFR 35.26 and costs that an issuer incurred to provide service to a wholesale or retail customer that subsequently becomes, in whole or in part, an unbundled transmission customer and that an issuer is authorized to recover by the FERC or a state regulatory authority.

(5) *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.

(6) *Transmission facilities*. *Transmission facilities* are facilities for the transmission or distribution of output. 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.

(7) *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 the 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 other output contract arrangements that are taken into account under the private business tests. 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.

(3) *Take contract or take or pay contract*—(i) *In general.* 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 the available output of a facility. See paragraphs (d) and (e) of this section for rules regarding measuring the use of, and payments on debt service for, an output facility for determining whether the private business tests are met.

(ii) *Transmission contracts.* In the case of a transmission facility, an agreement to provide firm or priority transmission services is generally treated as a take contract or a take or pay contract. The extent to which transmission services are interruptible is an important factor indicating that a contract for transmission services is not treated as a take contract or a take or pay contract.

(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)(3) 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—

(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 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 (such as significant termination payments) 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.

(5) *Contract with specific performance rights.* An output contract that provides the purchaser with specific rights to control the output of a facility or with other specific performance rights to the use of output of a facility is generally taken into account under the private business tests, even if the benefits and burdens test is not met. Payments made and to be made under such a contract are generally taken into account under the private payment test, even if the issuer does not reasonably expect that it is substantially certain that payments will be made under the contract (disregarding default, insolvency, or other similar circumstances). A customer's normal entitlement to receive utility service (for example, an entitlement to reasonable protection against blackouts in times of high demand through rotating the effects of blackouts) is not treated as a specific performance right for this purpose.

(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 capacity that must be reserved for the nongovernmental person under prudent reliability standards. For example, in the case of a take contract for a peaking electric generating unit, under which a nongovernmental person has priority rights to use capacity at any time for the entire term of the bonds, but under which the total energy purchases are limited in any one year to 10 percent of annual available output (determined by reference to nameplate capacity), the amount of private business use is the amount of capacity that must be reserved for that nongovernmental person under prudent reliability standards, which may be as much as 100 percent.

(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 purchaser is not required under the contract to make a payment that is substantially certain to be made under paragraph (c)(2)(ii) of this section in any year greater than 0.5 percent of the average annual debt service on an issue that finances the output facility.

(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.* The exceptions for short-term arrangements provided in § 1.141–3 (c) and (d)(3) apply to output contracts. For example, a spot sale for use for a period of 90 days on the basis of rates that are generally applicable and uniformly applied generally does not result in private business use, and a spot sale for use for a period of 30 days on the basis of rates that are specially negotiated generally does not result in private business use.

(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 output facility (not including a water 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.

(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 pursuant to a plan approved by the FERC).

(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)(ii) of this section.

(v) The contract mitigates stranded costs of the governmental owner that are attributable to the offer of the non-discriminatory, open access transmission tariffs referred to in paragraph (f)(5)(ii) of this section.

(vi) Any stranded costs recovered by the governmental owner (including amounts recovered under the contract) with respect to the output facility under rules promulgated by the FERC under the Federal Power Act (or comparable provisions of state law) are applied as promptly as is reasonably practical to redeem tax-exempt bonds that financed that 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 pursuant to a plan approved by the FERC); 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 by a state regulatory authority under comparable provisions of state law pursuant to a plan approved by the FERC). 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 to 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 issued before July 9, 1996; 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 25-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 21 years. H also will sell the remaining 40 percent of its share of the annual output to numerous other private utilities under contracts of 90 days or less entered into under a prevailing rate schedule, including demand charges. No contracts will be executed obligating any person other than Z 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 non-governmental person, under the rule in paragraph (c) of 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 paragraphs (b)(1) of this section is approximately 17,520,000 MWh. 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 20 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 16 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) J is required to reserve for T's use 40 MW of capacity in accordance with prudent reliability standards. Under paragraph (d) of this section, the amount of private business use under this contract, therefore, is approximately 20 percent (40 MW × 24 hours × 365 days × 10 years, or 3,504,000 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 16 MW of power (less the operation and maintenance costs directly attributable to generating that 16 MW of power), will be more than 10 percent of debt service on the issue on a present-value basis. The payment for 16 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 20 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 X 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 payment or security 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 independent system operator. (i) In 1998, 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 an independent system operator (ISO), 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 ISO. The functions of the ISO include control of transmission access and pricing, scheduling transmission, control area operations, and settlements and billing. In addition, under certain circumstances the ISO may order the transmission owners to construct additional transmission 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 1998, D transfers operating control of its transmission system to the ISO pursuant to the restructuring plan. At the same time, D chooses to apply the private activity bond regulations of §§ 1.141–0 through 1.141–15 to the 1994 bonds. The operation of the financed facilities by the ISO does not meet the exception for management contracts that do not give rise to private business use under § 1.141–3(b)(4)(iii)(C) because it is not a contract solely for the operation of a facility under that exception. 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 1999 to currently refund the 1994 bonds. The weighted average maturity of the 1999 bonds is not greater than the remaining weighted average maturity of the 1994 bonds. D chooses to apply the private activity bond regulations of §§ 1.141–0 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 ISO need not be taken into account in applying the reasonable expectations test to the refunding bonds.

§ 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, a bond is a private activity bond 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 more than 5 percent 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) More than 5 percent 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 more than 5 percent 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 date of each issue that finances the project, 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 among 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 and property for ancillary services, such as property required to be included in open access transmission tariffs under rules of the FERC. 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 project, 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 replaced property have a weighted average maturity that is not greater than 120 percent of the reasonably expected economic life of the replaced property.

(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 sales 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 revised to read as follows:

§ 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), 1.141–9 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).

(b) *Effective dates.* Except as otherwise provided in 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) 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.* 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 weighted average maturity of the refunding bonds is longer than—

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

(ii) 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

(2) 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.

(e) *Permissive retroactive application of certain sections.* The following sections may each be applied to any bonds issued before May 16, 1997—

(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 added to read as follows:

§ 1.141–15T Effective dates (temporary).

(a) through (e) [Reserved]. For 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 issued on or after February 23, 1998 that are subject to section 1301 of the Tax Reform Act of 1986 (100 Stat. 2602).

(2) *Transition rule for requirements contracts.* Section 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.

(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 bonds issued on or after February 23, 1998, to refund a bond to which the §§ 1.141–7T and 1.141–8T do not apply unless—

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

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

(ii) In the case of a short-term financings (such as a bond anticipation note), 120 percent of the weighted average reasonably expected economic life of the facilities financed; or

(2) A principal purpose of 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) Bonds that are outstanding on May 16, 1997, and subject to section 141; or

(2) Refunding bonds issued on or after May 16, 1997.

(i) *Permissive retroactive application of certain regulations pertaining to output contracts.* Section 1.141–7T(f) (4) and (5) may be applied to any bonds issued before February 23, 1998.

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

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

(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 142(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 later of—

(i) The date of the service area expansion that causes bonds to cease to meet the requirements of sections 142(a)(8) and 142(f); or

(ii) February 23, 1998.

(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 issue date 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.* Section 1.142(f)(4)–1 applies to elections made on or after February 23, 1998.

Par. 8. Section 1.150–5T is added to read as follows:

§ 1.150–5T Filing notices and elections (temporary).

(a) *In general.* Notices and elections under the following sections must be filed with the Chief, Employee Plans and Exempt Organizations) of the appropriate key district office—

(1) Section 1.141–12(d)(3); and

(2) Section 1.142(f)(4)–1T.

(b) *Effective dates.* This section applies to notices and elections filed on or after February 23, 1998.

Michael P. Dolan,

Deputy Commissioner of Internal Revenue.

Approved: December 23, 1997.

Jonathan Talisman,

Deputy Assistant Secretary of the Treasury.

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