

date that the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the issue financing the property (determined without regard to any optional redemption dates). The Final Regulations retain the basic approach in the 1994 Proposed Regulations relating to the measurement of private security and private payments.

The Final Regulations reserve § 1.141–13 for rules regarding the application of the private business tests and the private loan financing test to refunding issues. This document amends the Income Tax Regulations (26 CFR part 1) under section 141 by proposing rules on the application of the private business tests and the private loan financing test to refunding issues. This document also amends the Income Tax Regulations under sections 145, 149 and 150 by proposing rules on certain related matters. These regulations are published as proposed regulations (the proposed regulations) to provide an opportunity for public review and comment.

Explanation of Provisions

A. Application of Private Activity Bond Tests to Refunding Issues

1. In General

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

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

2. Allocation of Proceeds

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

3. Measurement of Private Business Use

The proposed regulations generally provide that the amount of private business use of a refunding issue is determined based on the separate measurement period for the refunding issue under § 1.141–3(g) (for example, without regard to any private business use that occurred before the issue date of the refunding issue). Thus, for instance, if an issuer refunds a taxable bond or an exempt facility bond, any private business use of the refinanced facilities before the issue date of the refunding issue is disregarded in applying the private business use test to the refunding issue.

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

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

4. Measurement of Private Security and Private Payments

If the amount of private business use is determined based on the separate measurement period for the refunding issue, then the amount of private security and private payments allocable

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

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

5. Multipurpose Issue Allocations

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

6. Application of Reasonable Expectations Test to Certain Refunding Bonds

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