

Outlines of topics to be discussed at the public hearing scheduled for November 4, 2003, at 10 a.m., must be received by October 14, 2003.

**ADDRESSES:** Send submissions to CC:PA:RU (REG-132483-03), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:RU (REG-132483-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at <http://www.irs.gov/regs>. The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations, Gary W. Bornholdt, (202) 622-3980; concerning submissions of comments, the hearing, and requests to be placed on the building access list to attend the meeting, Sonya M. Cruse, (202) 622-7180 (not toll-free numbers).

#### **SUPPLEMENTARY INFORMATION:**

##### **Background**

Section 103(a) of the Internal Revenue Code (Code) provides that, generally, interest on any State or local bond is not included in gross income. However, this exclusion does not apply to any private activity bond that is not a qualified bond.

##### *A. Governmental Bonds*

Under section 141, a bond is a private activity bond if the bond is issued as part of an issue that meets either (1) the private business use test and the private security or payment test (the private business tests), or (2) the private loan financing test.

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

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

of property, or borrowed money, used or to be used for a private business use.

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

Under § 1.141-2(d) of the Income Tax Regulations, 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. Under § 1.141-2(d), an issue is also an issue of private activity bonds 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.

Section 1.141-12 sets forth certain remedial actions that prevent a deliberate action with respect to property financed by an issue from causing that issue to meet the private business use test or the private loan financing test. Specifically, if an issuer satisfies certain conditions, an issuer may take one of the following three remedial actions to cure a deliberate action. First, the issuer may redeem or defease the nonqualified bonds. However, a defeasance is not a permitted remedial action if the period between the issue date and the first call date of the bonds is more than 10½ years (the 10½ year limitation). Second, if the deliberate action is a disposition of the bond-financed property for which the consideration is exclusively cash, and certain other requirements are met, the issuer may use the cash for an alternative qualifying use. Third, in certain cases, the facility with respect to which the deliberate action occurs may be used in an alternative qualifying manner (for example, the facility may be used for a qualifying purpose by a nongovernmental person or used by a 501(c)(3) organization rather than a governmental person). The second and third types of remedial action may cause a deemed reissuance of the nonqualified bonds (that is, a deemed issuance of new bonds to refund the nonqualified bonds) for certain purposes of the Code.

Section 1.141-12(j) provides that the percentage of outstanding bonds that are nonqualified bonds equals the highest percentage of private business use in any 1-year period commencing with the deliberate action. In addition, § 1.141-12(j) provides that the determination of the bonds of an issue that are treated as the nonqualified bonds must be made on a pro rata basis, except that, for purposes of the remedial action that involves the redemption or defeasance

of the nonqualified bonds, an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds.

In general, § 1.141-15 provides that § 1.141-12 applies to bonds issued on or after May 16, 1997, that are subject to section 1301 of the Tax Reform Act of 1986. However, issuers may apply the remedial action provisions in § 1.141-12 to any bonds to which § 1.141-12 does not otherwise apply.

##### *B. Qualified 501(c)(3) Bonds*

Under section 141(e), a qualified 501(c)(3) bond issued under section 145 may be a qualified bond. Section 145(a) provides that, in general, a qualified 501(c)(3) bond is any private activity bond issued as part of an issue if: (1) All of the property that is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit; and (2) such bond would not be a private activity bond if section 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses, determined by applying section 513(a). For this purpose, the private business tests are applied by using "5 percent" instead of "10 percent" each place it appears and "net proceeds" for "proceeds" each place it appears. Section 1.145-2 provides, in general, that §§ 1.141-0 through 1.141-15 apply to section 145(a).

##### *C. Exempt Facility Bonds*

Under section 141(e), an exempt facility bond issued under section 142 may be a qualified bond. Under section 142(a), an exempt facility bond is any bond issued as part of an issue if 95 percent or more of the net proceeds are to be used to provide certain exempt facilities.

Under § 1.142-2, if less than 95 percent of the net proceeds of an exempt facility bond are actually used to provide an exempt facility, and for no other purpose, the issue will be treated as meeting the use of proceeds requirement of section 142(a) if the issue meets a reasonable expectations test, and the issuer takes the remedial action described in § 1.142-2. The reasonable expectations test requires that the issuer must have reasonably expected on the issue date of the bonds that at least 95 percent of the net proceeds of the issue would be used to provide an exempt facility and for no other purpose for the entire term of the bonds (disregarding any redemption provisions). The remedial action provided in § 1.142-2 requires that the issuer redeem or defease the