

(e) *Investment-type property*—(1) *In general.* Investment-type property includes any property, other than property described in section 148(b)(2)(A), (B), (C) or (E), that is held principally as a passive vehicle for the production of income. For this purpose, production of income includes any benefit based on the time value of money.

(2) *Prepayments*—(i) *In general*—(A) *Generally.* Except as otherwise provided in this paragraph (e)(2), a prepayment for property or services, including a prepayment for property or services that is made after the date that the contract to buy the property or services is entered into, also gives rise to investment-type property if a principal purpose for prepaying is to receive an investment return from the time the prepayment is made until the time payment otherwise would be made. A prepayment does not give rise to investment-type property if—

(1) Prepayments on substantially the same terms are made by a substantial percentage of persons who are similarly situated to the issuer but who are not beneficiaries of tax-exempt financing;

(2) The prepayment is made within 90 days of the reasonably expected date of delivery to the issuer of all of the property or services for which the prepayment is made; or

(3) The prepayment meets the requirements of paragraph (e)(2)(iii)(A) or (B) of this section.

(B) *Example.* The following example illustrates an application of this paragraph (e)(2)(i):

*Example. Prepayment after contract is executed.* In 1998, City A enters into a ten-year contract with Company Y. Under the contract, Company Y is to provide services to City A over the term of the contract and in return City A will pay Company Y for its services as they are provided. In 2004, City A issues bonds to finance a lump sum payment to Company Y in satisfaction of City A's obligation to pay for Company Y's services to be provided over the remaining term of the contract. The use of bond proceeds to make the lump sum payment constitutes a prepayment for services under paragraph (e)(2)(i) of this section, even though the payment is made after the date that the contract is executed.

(ii) *Customary prepayments.* The determination of whether a prepayment satisfies paragraph (e)(2)(i)(A)(1) of this section is generally made based on all the facts and circumstances. In addition, a prepayment is deemed to satisfy paragraph (e)(2)(i)(A)(1) of this section if—

(A) The prepayment is made for—  
(1) Maintenance, repair, or an extended warranty with respect to personal property (for example,

automobiles or electronic equipment); or

(2) Updates or maintenance or support services with respect to computer software; and

(B) The same maintenance, repair, extended warranty, updates or maintenance or support services, as applicable, are regularly provided to nongovernmental persons on the same terms.

(iii) *Certain prepayments to acquire a supply of natural gas or electricity*—(A) *Natural gas prepayments.* A prepayment meets the requirements of this paragraph (e)(2)(iii)(A) if—

(1) It is made by or for one or more utilities that are owned by a governmental person, as defined in § 1.141–1(b) (each of which is referred to in this paragraph (e)(2)(iii)(A) as the issuing municipal utility), to purchase a supply of natural gas; and

(2) At least 90 percent of the prepaid natural gas financed by the issue is used for a qualifying use. Natural gas is used for a qualifying use if it is to be—

(i) Furnished to retail gas customers of the issuing municipal utility who are located in the natural gas service area of the issuing municipal utility, provided, however, that gas used to produce electricity for sale shall not be included under this paragraph (e)(2)(iii)(A)(2)(i);

(ii) Used by the issuing municipal utility to produce electricity that will be furnished to retail electric customers of the issuing municipal utility who are located in the electricity service area of the issuing municipal utility;

(iii) Used by the issuing municipal utility to produce electricity that will be sold to a utility that is owned by a governmental person and furnished to retail electric customers of the purchaser who are located in the electricity service area of the purchaser;

(iv) Sold to a utility that is owned by a governmental person if the requirements of paragraph (e)(2)(iii)(A)(2)(i), (ii) or (iii) of this section are satisfied by the purchaser (treating the purchaser as the issuing municipal utility); or

(v) Used to fuel the pipeline transportation of the prepaid gas supply acquired in accordance with this paragraph (e)(2)(iii)(A).

(B) *Electricity prepayments.* A prepayment meets the requirements of this paragraph (e)(2)(iii)(B) if—

(1) It is made by or for one or more utilities that are owned by a governmental person (each of which is referred to in this paragraph (e)(2)(iii)(B) as the issuing municipal utility) to purchase a supply of electricity; and

(2) At least 90 percent of the prepaid electricity financed by the issue is used

for a qualifying use. Electricity is used for a qualifying use if it is to be—

(i) Furnished to retail electric customers of the issuing municipal utility who are located in the electricity service area of the issuing municipal utility; or

(ii) Sold to a utility that is owned by a governmental person and furnished to retail electric customers of the purchaser who are located in the electricity service area of the purchaser.

(C) *Service area.* For purposes of this paragraph (e)(2)(iii), the service area of a utility owned by a governmental person consists of—

(1) Any area throughout which the utility provided, at all times during the 5-year period ending on the issue date—

(i) In the case of a natural gas utility, natural gas transmission or distribution service; and

(ii) In the case of an electric utility, electricity distribution service; and

(2) Any area recognized as the service area of the utility under state or Federal law.

(D) *Retail customer.* For purposes of this paragraph (e)(2)(iii), a retail customer is a customer that purchases natural gas or electricity, as applicable, other than for resale.

(E) *Commodity swaps.* A prepayment does not fail to meet the requirements of this paragraph (e)(2)(iii) by reason of any commodity swap contract that may be entered into between the issuer and an unrelated party (other than the gas or electricity supplier), or between the gas or electricity supplier and an unrelated party (other than the issuer), so long as each swap contract is an independent contract. A swap contract is an independent contract if the obligation of each party to perform under the swap contract is not dependent on performance by any person (other than the other party to the swap contract) under another contract (for example, a gas or electricity supply contract or another swap contract); provided, however, that a commodity swap contract will not fail to be an independent contract solely because the swap contract may terminate in the event of a failure of a gas or electricity supplier to deliver gas or electricity for which the swap contract is a hedge.

(F) *Remedial action.* Issuers may apply principles similar to the rules of § 1.141–12, including § 1.141–12(d) (relating to redemption or defeasance of nonqualified bonds) and § 1.141–12(e) (relating to alternative use of disposition proceeds), to cure a violation of paragraph (e)(2)(iii)(A)(2) or (e)(2)(iii)(B)(2) of this section. For this purpose, the amount of nonqualified bonds is determined in the same