

the IRS as prescribed in this preamble under the ADDRESSES heading. The IRS and the Treasury Department request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request.

A public hearing has been scheduled for February 5, 2014, at 2 p.m., in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic by December 16, 2013. Submit a signed paper original and eight (8) copies or an electronic copy. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Timothy Jones, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed 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 is amended by removing the entry for § 1.148–6 and revising the entry for §§ 1.148–0 through 1.148–11 to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Sections 1.148–0 through 1.148–11 also issued under 26 U.S.C. 148(i). \* \* \*

Par. 2. Section 1.148–0 is amended by adding entries to paragraph (c) for §§ 1.148–3(i)(3) and 1.148–11(k) and (l) and revising § 1.148–11 section heading to read as follows:

§ 1.148–0 Scope and table of contents.

\* \* \* \* \* (c) \* \* \*

§ 1.148–3 General arbitrage rebate rules.

\* \* \* \* \* (i) \* \* \* (3) Time and manner for requesting refund. \* \* \* \* \*

§ 1.148–11 Effective/applicability dates.

\* \* \* \* \* (k) [Reserved] (l) Additional arbitrage guidance updates. (1) [Reserved] (2) [Reserved] (3) [Reserved] (4) Application.

Par. 3. Section 1.148–3 is amended by adding paragraph (i)(3) to read as follows:

§ 1.148–3 General arbitrage rebate rules.

\* \* \* \* \* (i) \* \* \* (3) Time and manner for requesting refund—(i) An issuer must request a refund of an overpayment no later than the date that is 2 years after the final computation date for the issue to which the overpayment relates (the filing deadline). The request must be made using the form provided by the Commissioner for this purpose.

(ii) The Commissioner may request additional information to support a refund request. The issuer must file the additional information by the date specified in the Commissioner’s request which date may be extended by the Commissioner if unusual circumstances warrant.

(iii) A claim described in either paragraph (i)(3)(iii)(A) or (i)(3)(iii)(B) of this section that has been denied by the Commissioner may be appealed to the Office of Appeals under this paragraph (i)(3)(iii). Upon a determination in favor of the issuer, Appeals must return an undeveloped case to the Commissioner for further consideration of the substance of the claim.

(A) A claim is described in this paragraph (i)(3)(iii)(A) if the claim is filed after the filing deadline.

(B) A claim is described in this paragraph (i)(3)(iii)(B) if it is a claim for which additional information satisfactory to the Commissioner is not

submitted within the time specified in the request for information or any extension of such specified time period. \* \* \* \* \*

Par. 4. Section 1.148–11 is amended by revising the section heading and adding paragraphs (k) and (l) to read as follows:

§ 1.148–11 Effective/applicability dates.

\* \* \* \* \*

(k) [Reserved] (l) Additional arbitrage guidance updates. (1) [Reserved] (2) [Reserved] (3) [Reserved] (4) Application. (i) Section 1.148–3(i)(3)(i) applies to refund claims arising from an issue of bonds to which § 1.148–3(i) applies and for which the final computation date is after June 24, 2008. For purposes of this paragraph (l)(4), issues for which the actual final computation date is on or before June 24, 2008, are deemed to have a final computation date of July 1, 2008. (ii) Section 1.148–3(i)(3)(ii) and (iii) apply to refund claims arising from an issue of bonds to which § 1.148–3(i) applies and for which the final computation date is after September 16, 2013.

Beth Tucker, Deputy Commissioner for Operations Support.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–148659–07]

RIN 1545–BH38

Arbitrage Restrictions on Tax-Exempt Bonds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking and Notice of Public Hearing.

SUMMARY: This document contains proposed regulations on the arbitrage restrictions under section 148 of the Internal Revenue Code applicable to tax-exempt bonds and other tax-advantaged bonds. These proposed regulations amend existing regulations to address certain current market developments, simplify certain provisions, address certain technical issues, and make the regulations more administrable. These proposed regulations affect issuers of tax-exempt and other tax-advantaged

bonds. This document also provides notice of a public hearing on these proposed regulations.

**DATES:** Written or electronic comments must be received by December 16, 2013. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for February 5, 2014, at 10:00 a.m., must be received by December 16, 2013.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-148659-07), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-148659-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-148659-07). The public hearing will be held at the Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Zoran Stojanovic at (202) 622-3980; concerning submissions of comments and the hearing, Oluwafunmilayo Taylor at (202) 622-7180 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Paperwork Reduction Act**

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:CAR:MP:T:T:SP, Washington DC 20224. Comments on the collection of information should be received by November 15, 2013.

Comments are sought on whether the proposed collection of information is necessary for the proper performance of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques and other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in § 1.148-4(h)(2)(viii) which contains a requirement that the issuer maintain in its records a certificate provided by the hedge provider. Existing regulations require, among other items, that a hedge must be identified by the actual issuer on its books and records to be a qualified hedge. The identification must specify the hedge provider, the terms of the contract, and the hedged bonds. The proposed regulations require that the identification also include a certificate provided by the hedge provider specifying certain information regarding the hedge. The respondents are issuers of tax-exempt bonds that enter into hedges on their bonds and the hedge providers.

*Estimated total annual recordkeeping burden:* 232 hours.

*Estimated average annual burden hours per respondent:* 1 hour 45 minutes.

*Estimated number of respondents:* 130.

*Estimated annual frequency of responses:* 130.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by section 6103.

**Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) on the arbitrage investment restrictions under section 148 of the Internal Revenue Code (Code) and related provisions. On June 18, 1993, the Department of the Treasury (Treasury) and the IRS published comprehensive final regulations in the **Federal Register** (TD 8476, 58 FR 33510) on the arbitrage

investment restrictions and related provisions for tax-exempt bonds under sections 103, 148, 149, and 150, and, since that time, those final regulations have been amended in certain limited respects (the regulations issued in 1993 and the amendments thereto are collectively referred to as the Existing Regulations). A Notice of Proposed Rulemaking was published in the **Federal Register** (72 FR 54606; REG-106143-07) on September 26, 2007 (2007 Proposed Regulations), which proposes amendments to the Existing Regulations to address market developments, simplify certain provisions, address certain technical issues, and make the regulations more administrable. One notable change in the 2007 Proposed Regulations addresses a municipal market development in which issuers seek to modify interest rate risks by entering into hedging transactions that are based on taxable interest rate indexes (for example, LIBOR-based interest rate swaps). The 2007 Proposed Regulations clarify that these hedges qualify to be taken into account with the hedged bonds on a net basis in determining bond yield for arbitrage purposes. Among the other notable changes in the 2007 Proposed Regulations are (1) a revision to an investment bidding safe harbor to accommodate certain transparent internet-based electronic bidding procedures; (2) removal of the authority in the Existing Regulations to permit issuers of qualified mortgage bonds and qualified student loan bonds to compute a single joint bond yield for purposes of applying the arbitrage restrictions to two or more issues of these types of tax-exempt bonds; and (3) clarification that the amount an issuer is entitled to receive under a rebate refund claim is the excess of the total amount actually paid over the rebate amount. Among the technical changes in the 2007 Proposed Regulations are changes to the rules that address qualified hedges for arbitrage purposes and additions to the rules on permitted yield reduction payments. This document (the Proposed Regulations) proposes additional amendments to the Existing Regulations.

**Explanation of Provisions**

*I. Definitions and Elections (§ 1.148-1)*

*A. Issue price definition.* Section 148(h) provides that yield on an issue is to be determined on the basis of the issue price (within the meaning of sections 1273 and 1274). The issue price definition under the Existing Regulations generally follows the issue price definition used for computing

original issue discount on debt instruments under sections 1273 and 1274 of the Code, with certain modifications. Specifically, the issue price definition under the Existing Regulations applies a reasonable expectations standard (rather than a standard based on actual sales) for determining the issue price of bonds that are publicly offered. Under this standard, the first price at which a substantial amount (defined to mean ten percent) of the bonds is reasonably expected to be sold to the public is treated as the issue price and is used in determining the yield on the issue.

The standard uses reasonable expectations to allow issuers of advance refunding bonds to estimate the yield on the issue before the actual sales prices of the bonds are known so that the issuer can purchase yield-restricted investments for a refunding escrow to defease the prior bonds at the time of the sale of the refunding bonds. The issue prices of bonds with different payment and credit terms are determined separately. Notice 2010–35 (2010–19 IRB 660) provides that the arbitrage definition of issue price also applies to other tax-advantaged bond programs, including Build America Bonds under section 54AA and other Qualified Tax Credit Bonds under section 54A. See 26 CFR 601.601(d)(2).

The Treasury Department and the IRS are concerned that certain aspects of the Existing Regulations for determining the issue price of tax-exempt bonds are no longer appropriate in light of market developments since those regulations were published. In particular, the Treasury Department and the IRS are concerned that the ten-percent test does not always produce a representative price for the bonds. Underwriters of tax-exempt bonds may sell bonds of an issue with the same payment and credit terms in an initial public offering at different prices but execute the first ten percent of the sales of those bonds at the lowest price (and thus the highest yield), causing the issue price of the bonds to be a lower price than is representative of the prices at which the remaining bonds were sold.

In addition, increasing transparency about pricing information in the municipal bond market (for example, publicly-available pricing information from the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access (EMMA) platform) has led to heightened scrutiny of issue price standards. The reported data has shown, in certain instances, actual sales to the public at prices that differed significantly from the issue price used by the issuer. These

price differences have raised questions about the ability of the reasonable expectations standard to produce a representative issue price. The reported trade data has also called into question whether sales to underwriters and security dealers have been included as sales to the public in determining issue price in certain instances.

To address these concerns and to provide greater certainty, the Proposed Regulations amend the issue price definition used for arbitrage purposes in certain significant respects. Consistent with section 148(h), the Proposed Regulations retain the rule that issue price generally will be determined under the rules of sections 1273 and 1274. The Proposed Regulations remove the reference to issue price of bonds that are “publicly offered” because the existing section 1273 regulations do not distinguish between public offering and private placement. The Proposed Regulations parallel the language in the existing section 1273 regulations that refer to debt instruments issued for money.

The Proposed Regulations provide that the issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public. (As described further below, the Proposed Regulations define the term “public” to mean any person other than an “underwriter” and provide a new definition of the term “underwriter.”) The Proposed Regulations, however, remove the definition of substantial amount as ten percent. Instead, the Proposed Regulations provide a safe harbor under which an issuer may treat the first price at which a minimum of 25 percent of the bonds in an issue (with the same credit and payment terms) is sold to the public as the issue price, provided that all orders at this price received from the public during the offering period are filled (to the extent that the public orders at such price do not exceed the amount of bonds sold). Consistent with section 1273, the Proposed Regulations base the determination of issue price on actual sale prices instead of reasonably expected sale prices.

The Treasury Department and the IRS understand that, in the case of a refunding issue, an issuer may need to estimate the yield on the issue before the actual issue price can be determined so that the issuer can purchase yield-restricted investments for a refunding escrow to defease the prior bonds at the time of the sale of the refunding bonds. The Proposed Regulations provide relief in these situations by permitting issuers to make curative payments to the IRS, called “yield reduction payments,” to

reconcile differences between expected and actual issue prices of the refunding bonds for arbitrage compliance purposes.

The Existing Regulations disregard sales to “underwriters” or “wholesalers” in determining the issue price of tax-exempt bonds that are offered to the public. The Proposed Regulations provide that the issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public and, for this purpose, define the term “public” to mean any person other than an “underwriter.” The Proposed Regulations also define the term “underwriter” to mean any person that purchases bonds from the issuer for the purpose of effecting the original distribution of the bonds, or otherwise participates directly or indirectly in the original distribution. An underwriter includes a lead underwriter and any member of a syndicate that contractually agrees to participate in the underwriting of the bonds for the issuer. A securities dealer (whether or not a member of the issuer’s underwriting syndicate) that purchases bonds (whether or not from the issuer) for the purpose of effecting the original distribution of the bonds is also treated as an underwriter for this purpose. An underwriter generally includes a related party to an underwriter.

The Proposed Regulations eliminate the reference to “wholesalers” in the issue price definition, because the revised, more comprehensive definition of underwriter includes those persons who would otherwise be treated as “wholesalers” under the Existing Regulations.

Under the Proposed Regulations, a person that holds bonds for investment is not an underwriter with respect to those bonds. The Treasury Department and the IRS solicit public comment on whether specific identification rules, such as the section 1236(b) identification rules, should be provided for determining when a bond is held for investment.

*B. Working capital expenditures and replacement proceeds definition.* The Existing Regulations impose a number of arbitrage investment restrictions to limit arbitrage incentives for excessive use of tax-exempt bond financing for “working capital expenditures” (working capital), such as operating expenses or seasonal cash flow deficits (as distinguished from capital projects). The Proposed Regulations amend the treatment of working capital financings in several respects to simplify this area and to provide objective parameters for longer-term working capital financings.

An issuer is relieved of arbitrage investment restrictions on bond proceeds only after the proceeds are spent. The Existing Regulations impose a strict “bond proceeds-spent-last” accounting assumption for spending proceeds of tax-exempt bonds on working capital. This accounting rule recognizes that sources of funds are fungible and treats bond proceeds as spent for working capital purposes only after the issuer depletes other “available amounts” that the issuer otherwise could use for this purpose. An issuer, however, need not be “broke to borrow” for working capital purposes. Here, the Existing Regulations allow an issuer to maintain a “reasonable working capital reserve” fund that need not be spent before spending bond proceeds on working capital. The Existing Regulations provide a general rule that the permitted size of this reasonable working capital reserve fund is an objective measure equal to five percent of the issuer’s actual working capital expenditures in the previous fiscal year from operations. In addition, the Existing Regulations include a broad prohibition against direct or indirect financing of a working capital reserve itself. This prohibition against financing working capital reserves imposes another complex limit on the size of the permitted working capital reserve fund that requires analysis of amounts previously maintained for such purpose.

The Proposed Regulations remove the restriction against financing a working capital reserve. This restriction inappropriately penalizes those State and local governments that have previously maintained the least amount of working capital reserves and that may have the most bona fide need to finance working capital expenditures. Further, this restriction is complex. The Proposed Regulations retain the existing general five percent test for the size of a permitted reasonable working capital reserve fund.

The Existing Regulations also limit working capital financings through the concept of replacement proceeds. The arbitrage rules apply to more than the actual proceeds of the issue; they apply to gross proceeds, which include proceeds and replacement proceeds of an issue. The Existing Regulations provide broadly that replacement proceeds arise if an issuer reasonably expects as of the issue date that (1) the term of an issue will be longer than reasonably necessary for the governmental purposes of the issue, and (2) there will be available amounts for expenditures of the type being financed during the period that the issue remains outstanding longer than necessary. One

purpose of the replacement proceeds rules is to discourage issuers from issuing tax-exempt bonds with unduly long maturities or leaving tax-exempt bonds outstanding longer than reasonably necessary. The replacement proceeds rules particularly affect working capital financings.

The Existing Regulations provide a safe harbor against the creation of replacement proceeds for short-term working capital bond financings that are outstanding for no longer than two years. To address concerns about arbitrage incentives associated with certain short-term financing practices, however, Rev. Proc. 2002–31 (2002–1 CB 916) shortened the safe-harbor for these financings from two years to 13 months in most circumstances. Questions have arisen with respect to the interaction between the Existing Regulations and Rev. Proc. 2002–31. See 26 CFR 601.601(d)(2).

The Proposed Regulations provide that the maturity safe harbor against the creation of replacement proceeds for short-term working capital financings is 13 months. This change conforms the regulatory safe harbor to the more recent administrative standard under Rev. Proc. 2002–31 for the traditional short-term working capital financings for seasonal cash flow deficits.

The Existing Regulations, however, provide no safe harbors against the creation of replacement proceeds or other specific guidance regarding appropriate limits for longer-term working capital financings, such as longer-term deficit financings for issuers experiencing financial distress. State and local governments have sought guidance on appropriate parameters for such financings. The Proposed Regulations provide a new objective safe harbor against the creation of replacement proceeds for working capital financings that have terms longer than the proposed 13-month safe harbor. This new safe harbor requires an issuer to determine the first year in which it expects to have available amounts for working capital expenditures, monitor for actual available amounts in each year beginning with the year it first expects to have such amounts, and apply such available amounts in each year either to retire or to invest in tax-exempt bonds that are not investment property under section 148(b)(3) of the Code (that is, tax-exempt bonds that are not subject to the alternative minimum tax). Consistent with the purpose of the replacement proceeds rules, this new safe harbor aims to control the burden of unnecessary tax-exempt financings on the tax-exempt bond market by

requiring issuers to redeem or purchase tax-exempt bonds.

The Existing Regulations have a general arbitrage anti-abuse rule, which provides, in part, that specific factors (particularly bona fide cost under-runs and long-term financial distress) may justify a bond maturity that exceeds the maturity safe harbors against the creation of replacement proceeds. Separately, the Existing Regulations provide more favorable accounting rules for certain extraordinary, non-recurring working capital items, such as casualty losses. The Proposed Regulations add extraordinary working capital items to the factors that may justify a bond term beyond the maturity safe harbors against the creation of replacement proceeds.

## *II. Qualified Hedge Provisions* *(§ 1.148-4)*

To determine the yield on hedged bonds for purposes of the arbitrage investment restrictions, the Existing Regulations permit issuers to take into account and integrate the net payments on certain qualified hedges entered into to modify the risk of interest rate changes with the payments on the associated hedged tax-exempt bonds. In general, to be a qualified hedge, the terms of the hedge must correspond closely with those of the hedged bonds, the issuer must identify the hedge, and the hedge must contain no significant investment element.

The Existing Regulations provide that a termination of a qualified hedge includes any sale or other disposition of the hedge by the issuer or the acquisition by the issuer of an offsetting hedge. The Existing Regulations further provide that a deemed termination of a qualified hedge occurs when certain material modifications or assignments of a hedge result in a realization event to the issuer under section 1001. Under the Existing Regulations, if a hedge is deemed terminated, the issuer is deemed to have made or received a termination payment and, if applicable (such as when there is a material modification of the hedge), a deemed acquisition payment for a “new” hedge. Because the hedge is integrated with the bond yield, the deemed payments, like actual termination payments, can affect the yield on the bonds.

Issues have arisen in this area as a result of market conditions during the last several years. State and local governments have faced a number of circumstances that have put pressure on issuers to modify or terminate their existing qualified hedges. Treasury and the IRS have also received questions indicating that there is uncertainty about what constitutes an “offsetting

hedge” that terminates a qualified hedge.

In the 2007 Proposed Regulations, Treasury and the IRS solicited public comments regarding the types of offsetting hedges that are necessary for valid business purposes and recommendations on how to clarify the rule in the Existing Regulations regarding offsetting hedges. The Proposed Regulations consider those comments and propose rules that provide greater certainty regarding hedge terminations and clarify and simplify the treatment of modifications and terminations of qualified hedges.

*A. Modifications of qualified hedges.* The Proposed Regulations provide guidance on the treatment of modifications of qualified hedges while eliminating the concept of offsetting hedges. The Proposed Regulations provide that a modification, including an actual modification, an acquisition of another hedge, or an assignment, generally will result in a deemed termination of a hedge if the modification is material and results in a deemed disposition under section 1001.

The Proposed Regulations provide, however, that a material modification of a qualified hedge that otherwise would result in a deemed termination will not result in such a termination if the modified hedge is a qualified hedge. For this purpose, the Proposed Regulations require testing the modified hedge for compliance with the requirements for qualified hedges at the time of the modification.

These proposed changes generally produce results that are economically comparable to the Existing Regulations, but in a simpler manner. The Proposed Regulations reduce complexity associated with the approach under the Existing Regulations by eliminating the need to account for deemed hedge termination and acquisition payments, which deemed payments generally offset each other without substantive effect on the yield on the hedged bonds.

*B. Continuations of qualified hedges in refundings.* The Existing Regulations generally treat a refunding of hedged bonds as a deemed termination of a qualified hedge and require accounting for the deemed termination payment in the yield on the refunding bonds over the remaining term of the original hedge in accordance with economic substance. The Proposed Regulations simplify the treatment of qualified hedges upon refunding hedged bonds when there is no actual termination of the associated hedge. If the affected hedge meets the requirements for a qualified hedge of the refunding bonds as of the issue date of the refunding bonds, with certain

exceptions, the Proposed Regulations treat the affected hedge as continuing as a qualified hedge of the refunding bonds instead of being terminated. Similar to the proposed treatment of hedge modifications, the proposed treatment of these continuations of qualified hedges in refundings under the Proposed Regulations generally produces economically comparable results as the Existing Regulations in a simpler manner.

*C. Termination of hedges at fair market value.* The 2007 Proposed Regulations clarify that the termination payment for a termination or a deemed termination of a qualified hedge is equal to the fair market value of the hedge on the termination date. In response to comments received on the clarification in the 2007 Proposed Regulation, these Proposed Regulations modify the 2007 proposed rule. For a deemed termination of a qualified hedge, the Proposed Regulations provide that the amount of the termination payment is equal to the fair market value of the qualified hedge on the termination date. For an actual termination of a qualified hedge, the Proposed Regulations provide that the amount of the hedge termination payment treated as made or received on the hedged bonds (i) may not exceed the fair market value of the qualified hedge if paid by the issuer, and (ii) may not be less than the fair market value of the qualified hedge if received by the issuer. Comments on the 2007 Proposed Regulations as well as comments received in response to these Proposed Regulations will be considered in connection with finalizing this rule.

### III. Other Technical Changes

The Proposed Regulations make other technical changes to the Existing Regulations. This section describes the technical changes.

*A. Temporary period spending exception to yield restriction (§ 1.148–2).* The Existing Regulations provide certain short-term exceptions, called “temporary period” exceptions, which allow investment of proceeds of tax-exempt bonds for fairly short periods without yield restriction. These exceptions reduce administrative burdens and recognize that limited arbitrage potential exists for bond proceeds that are spent promptly.

The Existing Regulations provide no express exceptions for proceeds used for certain types of working capital expenditures, such as certain extraordinary working capital items. The Proposed Regulations broaden the existing 13-month temporary period exception to yield restriction for

restricted working capital expenditures to include all working capital expenditures.

*B. Certification of hedge provider (§ 1.148–4).* Concerns have been raised about pricing of hedges involving tax-exempt bonds. Existing regulations require, among other items, that a hedge must be identified by the actual issuer on its books and records to be a qualified hedge. The identification must specify the hedge provider, the terms of the contract, and the hedged bonds. To promote greater accountability and transparency about pricing of these hedges, the Proposed Regulations require that the identification also include a certificate provided by the hedge provider specifying certain information regarding the hedge including a statement about the bona fide, arm’s-length nature of the pricing and information about payments beyond those properly taken into account as payments to modify the risk of interest rate changes.

*C. Yield and valuation of investments (§ 1.148–5).* The Existing Regulations provide guidance on how to value investments allocated to an issue. Absent a special rule, the Existing Regulations give issuers the option to choose a valuation method, provided that the chosen method is consistently applied for arbitrage purposes on a valuation date. The special rules in the Existing Regulations leave some ambiguity about when the present value and the fair market value methods of valuation are permitted or required.

The Proposed Regulations clarify that the fair market value method of valuation generally is required for any investment (including a yield-restricted investment) on the date the investment is first allocated to an issue or first ceases to be allocated to an issue as a consequence of a deemed acquisition or a deemed disposition.

The Existing Regulations include only one exception to this mandatory fair market value rule. The issuer has the option to value an investment at present value when proceeds are allocated from one bond issue to another bond issue as transferred proceeds in refundings or universal cap allocations, provided that both affected bond issues consist exclusively of tax-exempt bonds. This exception applies only to transfers between two tax-exempt bond issues to address a concern about allocating excessive value to obligations without arbitrage restrictions. This exception, however, creates a disincentive against retiring tax-exempt bonds with taxable bonds, such as when the fair market value of the investment would cause investment yield to exceed the tax-

exempt bond yield. Such a disincentive is inconsistent with the general policies behind the arbitrage rules as stated in § 1.148-0. To provide more appropriate incentives, the Proposed Regulations change this rule to require only that the issue from which the investment is allocated (that is, the first issue in an allocation from one issue to another) consists exclusively of tax-exempt bonds.

D. *Authority of Commissioner under anti-abuse rule (§ 1.148-10)*. The Existing Regulations provide the Commissioner with authority to exercise discretion with respect to any transaction entered into for the principal purpose of obtaining a material financial advantage based on the difference between tax-exempt and taxable interest rates in a manner that is inconsistent with the arbitrage rules. The Proposed Regulations revise the Existing Regulations to clarify that the Commissioner has the authority to depart from the arbitrage rules as necessary to prevent such material financial advantage.

E. *Transition provision for certain guarantee funds (§ 1.148-11)*. Section 1.148-11(d)(1) provides a transition rule that allows certain State perpetual trust funds (for example, certain state permanent school funds) to pledge funds to guarantee tax-exempt bonds without resulting in arbitrage-restricted replacement proceeds. In Notice 2010-5 (2010-2 IRB 256) the Treasury Department and the IRS proposed to increase the amount of tax-exempt bonds that such funds could guarantee under this special rule and stated their intent to issue proposed regulations to implement this change. The Proposed Regulations include these changes. The Proposed Regulations also extend this rule to cover certain tax-exempt bonds issued to finance public charter schools in response to comments received on the Notice. See 26 CFR 601.601(d)(2).

F. *Definitions and special rules (§ 1.150-1)*.

1. *Definition of tax-advantaged bonds*. The Proposed Regulations provide a new definition of tax-advantaged bonds as tax-exempt bonds under section 103, taxable bonds that provide Federal tax credits to investors to subsidize the issuer's borrowing costs, and taxable bonds that provide refundable Federal tax credits payable directly to issuers under section 6431, or any future similar bonds that provide a Federal subsidy for any portion of an issuer's borrowing costs.

2. *Definition of issue*. The Existing Regulations provide that tax-exempt bonds and taxable bonds are not part of the same issue. Questions have arisen

regarding the appropriate treatment of taxable tax-advantaged bonds for purposes of this composite issue provision. The Proposed Regulations clarify that taxable tax-advantaged bonds and other taxable bonds are treated as part of different issues. The Proposed Regulations also clarify that different types of tax-advantaged bonds are treated as parts of different issues.

3. *Definition and treatment of grants*. The Existing Regulations include a definition of a grant. The Existing Regulations also provide a special arbitrage spending rule that treats proceeds used by an issuer to make a grant to an unrelated party as spent for arbitrage investment tracking purposes when the grant is made. A longstanding question is whether an issuer may look at the grantee's use of the grant funds to determine whether the bond issue complies with other arbitrage and general program restrictions on tax-exempt bonds. For example, taking into account the grantee's use may impact whether the issue finances capital projects or working capital expenditures, and accordingly which arbitrage rules apply to that issue. The Proposed Regulations expand the application of the existing definition of grant for arbitrage purposes to apply that definition to other tax-exempt bond provisions. The Proposed Regulations clarify that the character and nature of a grantee's use of proceeds generally is taken into account in determining whether other applicable non-arbitrage requirements of the issue are met.

#### IV. *Effective/Applicability Dates*

The Proposed Regulations generally are proposed to apply prospectively to bonds that are sold on or after the date that is 90 days after publication of final regulations in the **Federal Register**. Section 1.148-4(h)(2)(viii) is proposed to apply to qualified hedges that are entered into on or after the date that is 90 days after the date of publication of the final regulations in the **Federal Register**. Section 1.148-4(h)(3)(iv)(A) through (H) and (h)(4)(iv) are proposed to apply to hedges that are entered into on or after the date that is 90 days after the date of publication of final regulations in the **Federal Register**, to qualified hedges that are modified on or after such date with respect to such modifications, and to qualified hedges on bonds that are refunded on or after such date with respect to such refunding.

In addition, except as otherwise provided in the next paragraph, issuers may apply and rely upon the Proposed Regulations, in whole or in part, with respect to bonds that are sold on or after

September 16, 2013, and before the date that is 90 days after publication of final regulations in the **Federal Register**.

Issuers may apply and rely upon § 1.148-4(h)(3)(iv)(A) through (H) and (h)(4)(iv) of the Proposed Regulations in whole to hedges that are entered into on or after September 16, 2013, and before the date that is 90 days after publication of final regulations in the **Federal Register**; to qualified hedges that are modified on or after September 16, 2013, and before the date that is 90 days after publication of final regulations in the **Federal Register** with respect to such modifications; and to qualified hedges on bonds that are refunded on or after September 16, 2013, and before the date that is 90 days after publication of final regulations in the **Federal Register** with respect to such refunding.

#### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Some of the proposed changes clarify or simplify existing regulatory provisions, or otherwise involve simplifying or clarifying changes that will not have a significant economic impact on governmental jurisdictions or other entities of any size. These proposed regulations amend the issue price definition used for arbitrage purposes and provide a new objective safe harbor against the creation for replacement proceeds for long term working capital financings. These proposed changes are not expected to have a significant economic impact because they provide greater certainty to issuers and assist issuers in complying with the arbitrage restrictions on tax-exempt bonds.

Other proposed changes involve the treatment of certain hedging transactions, including requiring a certificate from a hedge provider. Although there is a lack of available data regarding the extent of usage of these hedging transactions by small entities, the IRS and the Treasury Department understand that these hedging transactions are used primarily by larger State and local governments and large counterparties. The IRS and the Treasury Department specifically solicit comment from any party,

particularly small entities, on the accuracy of this certification. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these Proposed Regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the ADDRESSES heading. The IRS and the Treasury Department request comments on all aspects of the proposed rules. All comments that are submitted by the public will be available for public inspection and copying at www.regulations.gov or upon request.

A public hearing has been scheduled for February 5, 2014, at 10:00 a.m. in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic by December 16, 2013. Submit a signed paper original and eight (8) copies or an electronic copy. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Johanna Som de Cerff, Office of Associate Chief Counsel (Financial Institutions and Products), IRS, and Vicky Tsilas, Office of Tax Policy. However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for § 1.148–6 and revising the entry for §§ 1.148–0 through 1.148–11 to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \* Sections 1.148–0 through 1.148–11 also issued under 26 U.S.C. 148(i).

Par. 2. Section 1.141–0 is amended by revising the section heading for § 1.141–15 and adding new entries for § 1.141–15(l), (m), and (n) to read as follows:

§ 1.141–0 Table of contents.

\* \* \* \* \*

§ 1.141–15 Effective/applicability dates.

\* \* \* \* \*

- (l) [Reserved]
(m) [Reserved]

(n) Effective/applicability dates for certain regulations relating to certain definitions.

\* \* \* \* \*

Par. 3. Section 1.141–1 is amended by revising paragraph (a) to read as follows:

§ 1.141–1 Definitions and rules of general application.

(a) In general. For purposes of §§ 1.141–0 through 1.141–16, the following definitions and rules apply: the definitions in this section, the definitions in § 1.150–1, the definition of placed in service in § 1.150–2(c), the definition of reasonably required reserve or replacement fund in § 1.148–2(f), and the definitions in § 1.148–1 of bond year, commingled fund, fixed yield issue, higher yielding investments, investment, investment proceeds, issue price, issuer, nonpurpose investment, purpose investment, qualified guarantee, qualified hedge, reasonable expectations or reasonableness, rebate amount, replacement proceeds, sale proceeds, variable yield issue and yield.

\* \* \* \* \*

Par. 4. Section 1.141–15 is amended by revising the section heading and adding paragraphs (l), (m), and (n) to read as follows:

§ 1.141–15 Effective/applicability dates.

\* \* \* \* \*

- (l) [Reserved]
(m) [Reserved]

(n) Effective/applicability dates for certain regulations relating to certain definitions. Revised § 1.141–1(a) applies to bonds that are sold on or after the date that is 90 days after publication of final regulations in the Federal Register. Par. 5. Section 1.148–0 is amended by adding new entries in paragraph (c) for §§ 1.148–1(f) and 1.148–11(k) and (l); and revising the entries for §§ 1.148–2(e)(3) and 1.148–10(e) and section heading for § 1.148–11 to read as follows:

§ 1.148–0 Scope and table of contents.

\* \* \* \* \*

(c) Table of contents. \* \* \*

§ 1.148–1 Definitions and elections.

\* \* \* \* \*

(f) Definition of issue price.

- (1) In general.
(2) Tax-exempt bonds issued for money.
(3) Definitions.
(4) Special rules.

§ 1.148–2 General arbitrage yield restriction rules.

\* \* \* \* \*

(3) Temporary period for working capital expenditures.

\* \* \* \* \*

§ 1.148–10 Anti-abuse rules and authority of Commissioner.

\* \* \* \* \*

(e) Authority of the Commissioner to prevent transactions that are inconsistent with the purpose of the arbitrage rules.

\* \* \* \* \*

§ 1.148–11 Effective/applicability dates.

\* \* \* \* \*

(k) [Reserved]
(l) Certain arbitrage guidance updates.

Par. 6. Section 1.148–1 is amended by:

- 1. Revising the definition of issue price in paragraph (b).
2. Revising paragraphs (c)(4)(i)(B)(I) and (c)(4)(ii).
3. Removing the “or” at the end of paragraph (c)(4)(i)(B)(2).
4. Removing the period at the end of paragraph (c)(4)(i)(B)(3) and adding in its place a semi-colon and the word “or”.
5. Adding a new paragraphs (c)(4)(i)(B)(4) and (f).

The additions and revisions read as follows:

§ 1.148–1 Definitions and elections.

\* \* \* \* \*

(b) \* \* \*

Issue price means issue price as defined in paragraph (f) of this section.

\* \* \* \* \*

- (c) \* \* \*  
 (4) \* \* \*  
 (i) \* \* \*  
 (B) \* \* \*

(I) For the portion of an issue that is to be used to finance restricted working capital expenditures, if that portion is not outstanding longer than the temporary period under § 1.148–2(e)(3) for which the proceeds qualify;

\* \* \* \* \*

(4) For the portion of an issue that is to be used to finance working capital expenditures and that is outstanding for a period longer than the temporary period under § 1.148–2(e)(3), if that portion satisfies paragraph (c)(4)(ii) of this section.

(ii) *Safe harbor for longer-term working capital financings.* A portion of an issue used to finance working capital expenditures satisfies this paragraph (c)(4)(ii) if the issuer meets the requirements of paragraphs (c)(4)(ii)(A) and (c)(4)(ii)(B) of this section.

(A) *Determine expected available amounts.* An issuer meets the requirements of this paragraph (c)(4)(ii)(A) if—

(I) On the issue date, the issuer determines the first fiscal year following the applicable temporary period (determined under § 1.148–2(e)) in which it reasonably expects to have available amounts for the financed working capital expenditures (first testing year), but in no event can the first testing year be later than five years after the issue date; and

(2) Beginning with the first testing year and for each subsequent fiscal year for which the applicable portion of the issue remains outstanding, the issuer determines its available amounts for the financed working capital expenditures as of the first day of the fiscal year (yearly available amount).

(B) *Application of yearly available amount to reduce burden on tax-exempt bond market.* An issuer meets the requirements of this paragraph (c)(4)(ii)(B) if, within 90 days after the start of each year in which it determines a yearly available amount, the issuer applies an amount equal to the yearly available amount for such year to redeem or invest in tax-exempt bonds that are excluded from investment property under section 148(b)(3) (that is, tax-exempt bonds that are not subject to the alternative minimum tax)(eligible tax-exempt bonds). The maximum amount required to be applied in such manner shall equal the outstanding principal amount of the applicable portion of the issue subject to the safe harbor in this paragraph (c)(4)(ii), determined as of the date of such

redemption or investment. Any amounts invested in eligible tax-exempt bonds shall be invested or reinvested continuously in such tax-exempt bonds, except during a permitted reinvestment period of no more than 30 days in a fiscal year, for as long as the applicable portion of the issue remains outstanding.

\* \* \* \* \*

(f) *Definition of issue price*—(1) *In general.* Except as otherwise provided in this paragraph (f), *issue price* is defined in sections 1273 and 1274 and the regulations under those sections. In determining the issue price under section 1274 of a bond that is issued for property, the adjusted applicable Federal rate, as computed for purposes of section 1288, is used in lieu of the applicable Federal rate in determining the issue price.

(2) *Tax-exempt bonds issued for money*—(i) *In general.* The issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public (as defined in paragraph (f)(3)(i) of this section). See paragraph (f)(4)(ii) of this section for an issue including bonds with different payment and credit terms.

(ii) *Safe harbor for determining issue price of tax-exempt bonds issued for money.* For purposes of paragraph (f)(2)(i) of this section, the issuer may treat the first price at which a minimum of 25 percent of the bonds is sold to the public as the issue price. However the preceding sentence applies only if all orders at this sale price received from the public within the offering period are filled to the extent the public orders at such price do not exceed the amount of bonds sold.

(3) *Definitions.* For purposes of this paragraph (f), the following definitions apply:

(i) *Public.* *Public* means any person (as defined in section 7701(a)(1)) other than an underwriter.

(ii) *Underwriter*—(A) *In general.* Except as otherwise provided in paragraph (f)(3)(ii)(C) of this section, the term *underwriter* means any person (as defined in section 7701(a)(1)) that purchases bonds from an issuer for the purpose of effecting the original distribution of the bonds or that otherwise participates directly or indirectly in such original distribution. An underwriter includes a lead underwriter and any member of a syndicate that contractually agrees to participate in the underwriting of the bonds for the issuer. A securities dealer (whether or not a member of an underwriting syndicate for the issuer)

that purchases bonds (whether or not from the issuer) for the purpose of effecting the original distribution of the bonds is also treated as an underwriter for purposes of this section

(B) *Certain related parties included.* Except as otherwise provided in paragraph (f)(3)(ii)(C) of this section, an underwriter includes any related party (as defined in § 1.150–1(b)) to an underwriter.

(C) *Holding for investment.* A person (as defined in section 7701(a)(1)) that holds bonds for investment is treated as a member of the public with respect to those bonds.

(iii) *Securities dealer.* *Securities dealer* means a dealer in securities, as defined in section 475(c)(1).

(4) *Special rules.* For purposes of this paragraph (f), the following special rules apply:

(i) *Subsequent sale at a different price.* The issue price as determined under paragraph (f)(1) or (2) of this section does not change if part of the issue is later sold at a different price.

(ii) *Separate determinations.* The issue price of bonds in an issue that do not have the same credit and payment terms is determined separately.

■ **Par. 7.** Section 1.148–2 is amended by revising paragraph (e)(3)(i) to read as follows:

**§ 1.148–2 General arbitrage yield restriction rules.**

\* \* \* \* \*

(e) \* \* \*

(3) \* \* \*

(i) *General rule.* The proceeds of an issue that are reasonably expected to be allocated to working capital expenditures within 13 months after the issue date qualify for a temporary period of 13 months beginning on the issue date. Paragraph (e)(2) of this section contains additional temporary period rules for certain working capital expenditures that are treated as part of a capital project.

\* \* \* \* \*

■ **Par. 8.** Section 1.148–4 is amended by:

■ 1. Revising paragraphs (h)(2)(viii) and (h)(3)(iv)(A).

■ 2. Redesignating paragraph (h)(3)(iv)(B) as newly redesignated paragraph (h)(3)(iv)(E) and revising newly redesignated paragraph (h)(3)(iv)(E).

■ 3. Redesignating paragraph (h)(3)(iv)(C) as newly redesignated paragraph (h)(3)(iv)(F) and revising the first sentence in newly redesignated paragraph (h)(3)(iv)(F).

■ 4. Redesignating paragraph (h)(3)(iv)(D) as newly redesignated paragraph (h)(3)(iv)(G) and revising



newly redesignated paragraph

(h)(3)(iv)(G).

■ 5. Redesignating paragraph

(h)(3)(iv)(E) as newly redesignated paragraph (h)(3)(iv)(H) and revising the first sentence in newly redesignated paragraph (h)(3)(iv)(H).

■ 6. Adding new paragraphs

(h)(3)(iv)(B), (h)(3)(iv)(C), (h)(3)(iv)(D) and (h)(4)(iv).

The revisions and additions read as follows:

**§ 1.148-4 Yield on an issue of bonds.**

\* \* \* \* \*

(h) \* \* \*

(2) \* \* \*

(viii) *Identification*—(A) *In general.*

The contract must be identified by the actual issuer on its books and records maintained for the hedged bonds not later than 15 calendar days after the date on which the issuer and the hedge provider enter into the hedge contract. The identification must be maintained by the actual issuer and must specify the name of the hedge provider, the terms of the contract, the hedged bonds, and include a hedge provider's certification as described in paragraph (h)(2)(viii)(B) of this section. The identification must contain sufficient detail to establish that the requirements of this paragraph (h)(2) and, if applicable, paragraph (h)(4) of this section are satisfied. In addition, the existence of the hedge must be noted on the first form relating to the issue of which the hedged bonds are a part that is filed with the Internal Revenue Service on or after the date on which the contract is identified pursuant to this paragraph (h)(2)(viii).

(B) *Hedge provider's certification.* The hedge provider's certification must provide that—

(1) The terms of the hedge were agreed to between a willing buyer and willing seller in a bona fide, arm's-length transaction;

(2) The rate payable by the issuer under the hedge is comparable to the rate that the hedge provider would have quoted on the trade date to enter into a reasonably comparable hedge with a counterparty that is similarly situated to the issuer and that involves a hedge on debt obligations other than tax-exempt bonds, taking into account all the terms of the hedge;

(3) The hedge provider has not made, and does not expect to make, any payment to any third party in connection with the hedge, except for any such third-party payment that the hedge provider expressly identifies in documents for the hedge; and

(4) The amounts paid or received pursuant to the hedge do not include

any payments other than payments reasonably allocable to the modification of risk of interest rate changes and to the hedge provider's overhead that are properly taken into account under paragraph (h)(3)(i) of this section, unless the hedge provider separately identifies such payments.

(3) \* \* \*

(iv) *Accounting for modifications and terminations*—(A) *Modification defined.*

A modification of a qualified hedge includes, without limitation, a change in the terms of the hedge, an issuer's acquisition of another hedge with terms that have the effect of modifying an issuer's risks of interest rate changes or other terms of an existing qualified hedge, or an assignment of a hedge provider's remaining rights and obligations under the hedge to a third party. For example, if the issuer enters into a qualified hedge that is an interest rate swap under which it receives payments based on LIBOR, and subsequently enters a second hedge (with the same or different provider) that limits the issuer's exposure under the existing qualified hedge to variations in LIBOR, the new hedge modifies the qualified hedge.

(B) *Termination defined.* A termination means either an actual or a deemed termination of a qualified hedge. Except as otherwise provided, an actual termination of a qualified hedge occurs to the extent that the issuer sells, disposes of, or otherwise actually terminates all or a portion of the hedge. A deemed termination of a qualified hedge occurs if the hedge ceases to meet the requirements for a qualified hedge of the hedged bonds; the issuer makes a modification (as defined in paragraph (h)(3)(iv)(A) of this section) that results in a deemed exchange of the hedge and a realization event to the issuer under section 1001; or the issuer redeems all or a portion of the hedged bonds.

(C) *Special rules for certain modifications when the hedge remains qualified.* A modification of a qualified hedge that otherwise would result in a deemed termination under paragraph (h)(3)(iv)(B) of this section does not result in such a termination if the modified hedge meets the requirements for a qualified hedge, determined as of the date of the modification. For purposes of this paragraph (h)(3)(iv)(C), when determining whether the hedge is qualified, the fact that the existing qualified hedge is off-market as of the date of the modification is disregarded and the identification requirement in paragraph (h)(2)(viii) of this section applies by measuring the time period for identification from the date of the modification and without regard to the

requirement for a hedge provider's certification.

(D) *Continuations of certain qualified hedges in refundings.* If hedged bonds are redeemed using proceeds of a refunding issue, the qualified hedge is not actually terminated, and the hedge meets the requirements for a qualified hedge for the refunding bonds as of the issue date of the refunding bonds, then no termination of the hedge occurs and the hedge instead is treated as a qualified hedge for the refunding bonds. For purposes of this paragraph (h)(3)(iv)(D), when determining whether the hedge is a qualified hedge for the refunding bonds, the fact that the hedge is off-market with respect to the refunding bonds as of the issue date of the refunding bonds is disregarded and the identification requirement in paragraph (h)(2)(viii) of this section applies by measuring the time period for identification from the issue date of the refunding bonds and without regard to the requirement for a hedge provider's certification.

(E) *General allocation rules for hedge termination payments.* Except as otherwise provided in paragraphs (h)(3)(iv)(F), (G), and (H) of this section, a payment made or received by an issuer to terminate a qualified hedge, or a payment deemed made or received for a deemed termination, is treated as a payment made or received, as appropriate, on the hedged bonds. Upon an actual termination of a qualified hedge, the amount of the payment that an issuer may treat as a termination payment made or received on the hedged bonds—

(1) May not exceed the fair market value of the qualified hedge on such date if paid by the issuer; and

(2) May not be less than the fair market value of the qualified hedge on such date if received by the issuer.

Upon a deemed termination of a qualified hedge, the amount of the termination payment is equal to the fair market value of the qualified hedge on the termination date. Except as otherwise provided, a termination payment is reasonably allocated to the remaining periods originally covered by the terminated hedge in a manner that reflects the economic substance of the hedge.

(F) *Special rule for terminations when bonds are redeemed.* Except as otherwise provided in this paragraph (h)(3)(iv)(F) and in paragraph (h)(3)(iv)(G) of this section, when a qualified hedge is deemed terminated because the hedged bonds are redeemed, the termination payment as determined under paragraph

(h)(3)(iv)(E) of this section is treated as made or received on that date. \* \* \*

(G) *Special rules for refundings.* When there is a termination of a qualified hedge because there is a refunding of the hedged bonds, to the extent that the hedged bonds are redeemed using the proceeds of a refunding issue, the termination payment is accounted for under paragraph (h)(3)(iv)(E) of this section by treating it as a payment on the refunding issue, rather than the hedged bonds. In addition, to the extent that the refunding issue is redeemed during the period to which the termination payment has been allocated to that issue, paragraph (h)(3)(iv)(F) of this section applies to the termination payment by treating it as a payment on the redeemed refunding issue.

(H) *Safe harbor for allocation of certain termination payments.* A payment to terminate a qualified hedge does not result in that hedge failing to satisfy the applicable provisions of paragraph (h)(3)(iv)(E) of this section if that payment is allocated in accordance with this paragraph (h)(3)(iv)(H). \* \* \*

(iv) *Consequences of certain modifications.* The special rules under paragraph (h)(4)(iii) of this section regarding the effects of terminations of qualified hedges of fixed yield hedged bonds also applies in the same manner to modifications of a qualified hedge under paragraph (h)(3)(iv)(C) of this section. Thus, for example, a modification may result in a prospective change in the yield on the hedged bonds for arbitrage rebate purposes under § 1.148-3.

\* \* \* \* \*

■ **Par. 9.** Section 1.148-5 is amended by:

■ 1. Revising paragraphs (c)(3), (d)(2) and (d)(3).

■ 2. Revising the last sentence in paragraph (d)(6)(i) and adding a sentence at the end of the paragraph.

The revisions and additions read as follows:

**§ 1.148-5 Yield and valuation of investments.**

\* \* \* \* \*

(c) \* \* \*

(3) *Applicability of special yield reduction rule—(i) through (ix)* [Reserved].

(x) Investments allocable to gross proceeds of an issue to the extent that the yield reduction payments made with respect to such investments under paragraph (c)(1) of this section relate to any difference between the amount of the actual issue price of the issue and the issuer's reasonable expectations

regarding such issue price determined as of the sale date of the issue.

(d) \* \* \*

(2) *Mandatory valuation of certain yield restricted investments at present value.* Except as otherwise provided in paragraphs (b)(3) and (d)(3) of this section, a yield restricted investment must be valued at present value.

(3) *Mandatory valuation of certain investments at fair market value—(i) In general.* Except as otherwise provided in paragraphs (d)(3)(ii) and (d)(4) of this section, an investment must be valued at fair market value on the date that it is first allocated to an issue or first ceases to be allocated to an issue as a consequence of a deemed acquisition or deemed disposition. For example, if an issuer deposits existing nonpurpose investments into a sinking fund for an issue, those investments must be valued at fair market value as of the date first deposited into the fund.

(ii) *Exception to fair market value requirement for transferred proceeds allocations, universal cap allocations, and commingled funds.* Paragraph (d)(3)(i) of this section does not apply if the investment is allocated from one issue to another as a result of the transferred proceeds allocation rule under § 1.148-9(b) or the universal cap rule under § 1.148-6(b)(2), provided that the issue from which the investment is allocated (that is, the first issue in an allocation from one issue to another) consists exclusively of tax-exempt bonds. In addition, paragraph (d)(3)(i) of this section does not apply to investments in a commingled fund (other than a bona fide debt service fund) unless it is an investment being initially deposited in or withdrawn from a commingled fund described in § 1.148-6(e)(5)(ii).

\* \* \* \* \*

(6) \* \* \* (i) \* \* \* On the purchase date, the fair market value of a United States Treasury obligation that is purchased directly from the United States Treasury, including a State and Local Government Series (SLGS) security, is its purchase price. The fair market value of a SLGS security on any date other than the original purchase date is the redemption price for redemption on that date.

\* \* \* \* \*

**§ 1.148-6 [Amended]**

■ **Par. 10.** In § 1.148-6, paragraph (d)(4)(iii) is removed.

■ **Par. 11.** Section 1.148-10 is amended by revising the last sentence of paragraph (a)(4) and the heading and first sentence of paragraph (e) to read as follows:

**§ 1.148-10 Anti-abuse rules and authority of Commissioner.**

(a) \* \* \*

(4) \* \* \* These factors may be outweighed by other factors, such as bona fide cost underruns, an issuer's bona fide need to finance extraordinary working capital items, or an issuer's long-term financial distress.

\* \* \* \* \*

(e) *Authority of the Commissioner to prevent transactions that are inconsistent with the purpose of the arbitrage rules.* If an issuer enters into a transaction for a principal purpose of obtaining a material financial advantage based on the difference between tax-exempt and taxable interest rates in a manner that is inconsistent with the purposes of section 148, the Commissioner may exercise the Commissioner's discretion to depart from the rules of §§ 1.148-1 through 1.148-11 as necessary to prevent such financial advantage. \* \* \*

■ **Par. 12.** Section 1.148-11 is amended by:

■ 1. Revising the section heading.

■ 2. Redesignating paragraph (d)(1) as newly redesignated paragraph (d)(1)(i).

■ 3. Redesignating paragraphs (d)(1)(i), (d)(1)(ii), (d)(1)(iii), (d)(1)(iv), (d)(1)(v), and (d)(1)(vi) as newly redesignated paragraphs (d)(1)(i)(A), (d)(1)(i)(B), (d)(1)(i)(C), (d)(1)(i)(D), (d)(1)(i)(E), and (d)(1)(i)(F), respectively.

■ 4. Revising newly redesignated paragraphs (d)(1)(i)(B), (d)(1)(i)(D), and (d)(1)(i)(F), and adding new paragraphs (d)(1)(ii), (k) and (l).

The revisions and additions read as follows:

**§ 1.148-11 Effective/applicability dates.**

\* \* \* \* \*

(d) \* \* \*

(1) \* \* \*

(i) \* \* \*

(B) The corpus of the guarantee fund may be invaded only to support specifically designated essential governmental functions (designated functions) carried on by political subdivisions with general taxing powers or public elementary and public secondary schools;

\* \* \* \* \*

(D) The issue guaranteed consists of obligations that are not private activity bonds (other than qualified 501(c)(3) bonds) substantially all of the proceeds of which are to be used for designated functions;

\* \* \* \* \*

(F) As of the sale date of the bonds to be guaranteed, the amount of the bonds to be guaranteed by the fund plus the then-outstanding amount of bonds

previously guaranteed by the fund does not exceed a total amount equal to 500 percent of the total costs of the assets held by the fund as of December 16, 2009.

(ii) The Commissioner may, by published guidance, set forth additional circumstances under which guarantees by certain perpetual trust funds will not cause amounts in the fund to be treated as replacement proceeds.

\* \* \* \* \*

(k) [Reserved]

(l) *Additional arbitrage guidance updates*—(1) *In general.* Sections 1.148–1(b); 1.148–1(c)(4)(i)(B)(J); 1.148–1(c)(4)(i)(B)(4); 1.148–1(c)(4)(ii); 1.148–1(f); 1.148–2(e)(3)(i); 1.148–5(c)(3); 1.148–5(d)(2); 1.148–5(d)(3); 1.148–5(d)(6)(i); 1.148–6(d)(4); 1.148–10(a)(4); 1.148–10(e); 1.148–11(d)(1)(i)(B); 1.148–11(d)(1)(i)(D); 1.148–11(d)(1)(i)(F); and 1.148–11(d)(1)(ii) apply to bonds that are sold on or after the date that is 90 days after the date of publication of final regulations in the **Federal Register**.

(2) Section 1.148–4(h)(2)(viii) applies to hedges that are entered into on or after the date that is 90 days after the date of publication of the final regulations in the **Federal Register**.

(3) Section 1.148–4(h)(3)(iv)(A) through (H) and (h)(4)(iv) apply to—

(i) Hedges that are entered into on or after the date that is 90 days after the date of publication of the final regulations in the **Federal Register**;

(ii) Qualified hedges that are modified on or after the date that is 90 days after the date of publication of the final regulations in the **Federal Register** with respect to modifications on or after such date; and

(iii) Qualified hedges on bonds that are refunded on or after the date that is 90 days after the date of publication of the final regulations in the **Federal Register** with respect to the refunding on or after such date.

■ **Par. 13.** Section 1.150–1 is amended by:

- 1. Adding a new paragraph (a)(2)(iii).
- 2. Adding a definition for tax-advantaged bond in alphabetical order to paragraph (b).
- 3. Revising paragraph (c)(2).
- 4. Adding a new paragraph (f).

The revisions and additions read as follows:

**§ 1.150–1 Definitions.**

(a) \* \* \*

(2) \* \* \*

(iii) *Special effective date for definitions of tax-advantaged bond, issue, and grant.* The definition of *tax-advantaged bond* in paragraph (b) of this section, the revisions to the definition of *issue* in paragraph (c)(2) of

this section, and the definition and rules regarding the treatment of grants in paragraph (f) of this section apply to bonds that are sold on or after the date that is 90 days after publication of final regulations in the **Federal Register**.

\* \* \* \* \*

(b) \* \* \*

*Tax-advantaged bond* means a tax-exempt bond, a taxable bond that provides a Federal tax credit to the investor with respect to the issuer’s borrowing costs, a taxable bond that provides a refundable Federal tax credit payable directly to the issuer of the bond for its borrowing costs under section 6431, or any future similar bond that provides a Federal subsidy for any portion of the borrowing costs. Examples of tax-advantaged bonds include qualified tax credit bonds under section 54A(d)(1) and build America bonds under section 54AA.

\* \* \* \* \*

(c) \* \* \*

(2) *Exceptions for different types of tax-advantaged bonds and taxable bonds.* Each type of tax-advantaged bond that has a different structure for delivery of the borrowing subsidy or different program eligibility requirements is treated as part of a different issue under this paragraph (c). Further, tax-advantaged bonds and bonds that are not tax-advantaged bonds are treated as part of different issues under this paragraph (c). The issuance of tax-advantaged bonds in a transaction with other non tax-advantaged bonds must be tested under the arbitrage anti-abuse rules under § 1.148–10(a) and other applicable anti-abuse rules (for example, limitations against window maturity structures or unreasonable allocations of bonds).

\* \* \* \* \*

(f) *Definition and treatment of grants*—(1) *Definition.* *Grant* means a transfer for a governmental purpose of money or property to a transferee that is not a related party to or an agent of the transferor. The transfer must not impose any obligation or condition to directly or indirectly repay any amount to the transferor or a related party. Obligations or conditions intended solely to assure expenditure of the transferred moneys in accordance with the governmental purpose of the transfer do not prevent a transfer from being a grant.

(2) *Treatment.* Except as otherwise provided (for example, § 1.148–6(d)(4), which treats proceeds used for grants as spent for arbitrage purposes when the grant is made), the character and nature of a grantee’s use of proceeds are taken into account in determining which rules are applicable to the bond issue and

whether the applicable requirements for the bond issue are met.

For example, a grantee’s use of proceeds generally determines whether the proceeds are used for capital projects or working capital expenditures under section 148 and whether the qualified purposes for the specific type of bond issue are met.

**Beth Tucker,**  
*Deputy Commissioner for Operations Support.*

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**DEPARTMENT OF JUSTICE**

**28 CFR Part 16**

[CPCLO Order No. 005–2013]

**Exemption of Records Systems Under the Privacy Act**

**AGENCY:** Executive Office for Organized Crime Drug Enforcement Task Forces (OCDETF), Department of Justice.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Department of Justice (the Department or DOJ) proposes to amend its Privacy Act regulations for two systems of records entitled the “Drug Enforcement Task Force Evaluation and Reporting System, JUSTICE/DAG–003,” last published, March 10, 1992 in the **Federal Register**, and the “Organized Crime Drug Enforcement Task Force Fusion Center and International Organized Crime Intelligence and Operations Center System, JUSTICE/CRM–028,” last published, June 3, 2009 in the **Federal Register**. These Privacy Act regulations are being amended to reflect a recent reorganization of the Department establishing the Executive Office for OCDETF as a separate DOJ component, and transferring responsibility for these systems from the Office of the Deputy Attorney General (ODAG) and the Criminal Division to this component. In light of this departmental reorganization, JUSTICE/DAG–003 is being renumbered to JUSTICE/OCDETF–001 and will be renamed as the “Organized Crime Drug Enforcement Task Forces Management Information System (OCDETF MIS).” JUSTICE/CRM–028 is being renumbered to JUSTICE/OCDETF–002 but will retain its system name. When under the responsibility of ODAG and the Criminal Division, these systems were exempted from certain provisions of the Privacy Act of 1974 by exemptions placed in the Code of Federal Regulations (CFR) sections containing