Clarification of Proposed Regulations Relating to Tax-exempt Bonds Issued by State or Local Governments (REG-113526-98; REG-105369-00)

## Notice 2002-52

#### PURPOSE

On April 17, 2002, the Treasury Department and the Internal Revenue Service published in the Federal Register proposed regulations under sections 141 and 148 of the Internal Revenue Code relating to tax-exempt bonds issued by state or local governments (REG-113526-98; REG-105369-00) (the proposed regulations). This notice clarifies the application of certain provisions of the proposed regulations relating to natural gas prepayments.

#### BACKGROUND

The proposed regulations propose to amend the definition of private loan in § 1.141-5(c) and the definition of investment-type property in § 1.148-1(e). In particular, the proposed regulations address the circumstances in which a prepayment for property or services will be treated as a loan for purposes of the private loan financing test of section 141(c), or will give rise to investment-type property under section 148(b)(2)(D). Among other things, the proposed regulations add an exception to the definitions of private loan and investmenttype property for natural gas prepayments that meet certain requirements set forth in § 1.148-1(e)(2)(i) of the proposed regulations.

Section 1.148-1(e)(2)(ii)(C) of the proposed regulations states that a transaction will not fail to qualify for this exception by reason of any commodity swap contract that may be entered into between the issuer and an unrelated party (other than the gas supplier), or between the gas supplier and an unrelated party (other than the issuer), so long as each swap contract is an independent contract. For this purpose, § 1.148-1(e)(2)(ii)(C) provides that 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 supply contract or another swap contract).

Questions have arisen regarding the characterization in § 1.148-1(e)(2)(ii)(C) of when a swap contract will constitute an independent contract. Comments have been received indicating that the practices and policies of certain state and local governments require that if an issuer enters into a commodity swap contract, the swap contract must terminate if the supplier of the commodity being hedged fails to deliver the commodity to the issuer.

# CLARIFICATION OF PROPOSED REGULATIONS

For purposes of § 1.148-1(e)(2)(ii)(C) of the proposed regulations, a natural gas 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 supplier to deliver gas for which the swap contract is a hedge. Comments are requested on the limitations on commodity swap contracts contained in § 1.148-1(e)(2)(ii)(C) of the proposed regulations.

Issuers may rely on this notice as if it were included in the proposed regulations.

## FURTHER INFORMATION

For further information regarding this notice, contact Johanna Som de Cerff at (202) 622-3980 (not a toll free call).