

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 1.148-10: Anti-abuse rules and Authority of Commissioner.
(Also Part I, §§ 103, 148, 1.148-1, 148-2, 148-6)

Rev. Proc. 2002-31

SECTION 1. PURPOSE

This final revenue procedure sets forth a safe harbor under which an issue of tax or revenue anticipation bonds will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of the bonds for purposes of § 1.148-10(a)(4) of the Income Tax Regulations. On August 20, 2001, this revenue procedure was published in proposed form as Notice 2001-49, 2001-34 I.R.B. 188. Public comments were invited concerning the proposed revenue procedure and none were received. This final revenue procedure is unchanged from the proposed revenue procedure.

SECTION 2. BACKGROUND

01. Section 103(a) of the Internal Revenue Code of 1986 provides that, except as provided in section 103(b), gross income does not include interest on any state or local bond.

02. Section 103(b) provides that the exclusion described in section 103(a) does not apply to any arbitrage bond.

03. Section 148(a) provides that an arbitrage bond is any bond issued as part of an issue any portion of the proceeds of which are to be used directly or indirectly-

(1) to acquire higher yielding investments, or

(2) to replace funds which were used directly or indirectly to acquire higher yielding investments.

04. Section 148(c)(1) provides that a bond will not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such bond is a part may be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which such issue was issued.

05. Section 1.148-2(e)(3)(i) of the Income Tax Regulations

provides that the proceeds of an issue that are reasonably expected to be allocated to restricted working capital expenditures within 13 months after the issue date qualify for a temporary period of 13 months beginning on the issue date.

06. Section 1.148-2(e)(3)(ii) provides that if an issuer reasonably expects to use tax revenues arising from tax levies for a single fiscal year to redeem or retire an issue, and the issue matures by the earlier of 2 years after the issue date or 60 days after the last date for payment of those taxes without interest or penalty, the temporary period under § 1.148-2(e)(3)(i) is extended until the maturity date of the issue.

07. Section 1.148-1(b) provides that restricted working capital expenditures are working capital expenditures that are subject to the proceeds-spent-last rule in § 1.148-6(d)(3)(i) and are ineligible for any exception to that rule.

08. Section 1.148-10(a)(1) provides that bonds of an issue are arbitrage bonds if an abusive arbitrage device under § 1.148-10(a)(2) is used in connection with the issue.

09. Section 1.148-10(a)(2) provides that any action is an abusive arbitrage device if the action has the effect of (i) enabling the issuer to exploit the difference between tax-exempt and taxable interest rates to obtain a material financial advantage and (ii) overburdening the tax-exempt bond market.

10. Section 1.148-10(a)(4) provides that an action overburdens the tax-exempt bond market if it results in issuing more bonds, issuing bonds earlier, or allowing bonds to remain outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes of the bonds, based on all the facts and circumstances.

11. Under § 1.148-10(a)(4), one factor evidencing that bonds may remain outstanding longer than necessary is a term that exceeds the safe harbors against the creation of replacement proceeds under § 1.148-1(c)(4)(i)(B). This factor may be outweighed by other factors, however, such as long-term financial distress.

12. Section 1.148-1(c)(4)(i)(A) provides that certain replacement proceeds arise to the extent that the issuer reasonably expects as of the issue date that the term of the issue will be longer than is reasonably necessary for the governmental purposes of the issue and that there will be available amounts during the period that the issue remains outstanding longer than necessary. Whether an issue is outstanding longer than necessary is determined under § 1.148-10.

13. Section 1.148-1(c)(4)(i)(B)(1) provides a safe harbor against the creation of replacement proceeds under § 1.148-1(c)(4)(i)(A) for the portion of an issue that finances

restricted working capital expenditures. This safe harbor is met if that portion is not outstanding longer than 2 years.

14. Section 1.148-1(c)(4)(i)(B)(2) provides a safe harbor against the creation of replacement proceeds under § 1.148-1(c)(4)(i)(A) for the portion of an issue (including a refunding issue) that finances or refinances capital projects. This safe harbor is met if that portion has a weighted average maturity that does not exceed 120 percent of the average reasonably expected economic life of the financed capital projects.

15. Section 1.148-10(d) contains examples illustrating the application of the anti-abuse rules of § 1.148-10. Example 2(i) describes a particular transaction in which an issue is deemed to have a longer weighted average maturity than necessary, notwithstanding that the issue satisfies the safe harbor against the creation of replacement proceeds in § 1.148-1(c)(4)(i)(B)(2).

SECTION 3. SCOPE

This revenue procedure applies to an issue of tax or revenue anticipation bonds the proceeds of which qualify for a temporary period for restricted working capital expenditures under § 1.148-2(e)(3).

SECTION 4. SAFE HARBOR

For purposes of § 1.148-10(a)(4), an issue of tax or revenue anticipation bonds within the scope of this revenue procedure will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of those bonds if the final maturity date of the issue is not later than the end of the applicable temporary period under § 1.148-2(e)(3)(i) or § 1.148-2(e)(3)(ii) for which proceeds of the issue qualify. This revenue procedure does not apply to determine whether an issue of tax or revenue anticipation bonds meets the other requirements of section 148.

SECTION 5. ADVANCE RULINGS

The Service will consider requests for rulings on proposed issues of tax or revenue anticipation bonds that do not satisfy the safe harbor provided in section 4.

SECTION 6. EFFECTIVE DATE

This revenue procedure applies to tax or revenue anticipation bonds sold after May 13, 2002.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Rose M. Weber and Timothy L. Jones of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government

Entities). However, other personnel from the IRS and Treasury Department participated in the development of this revenue procedure. For further information regarding this revenue procedure contact Rose M. Weber or Timothy L. Jones on (202) 622-3980 (not a toll-free call).