

Rev. Proc. 95-47

1995-2 C.B. 417; 1995-47 I.R.B. 12

November 20, 1995

Section 1. PURPOSE

This revenue procedure sets forth the conditions under which an issuer of State or local bonds may make payments to the United States to reduce the yield on investments purchased with the proceeds of advance refunding bonds on a date when the issuer is unable to purchase United States Treasury securities – State and Local Government Series (“SLGs”) because the Department of the Treasury has suspended sales of SLGs.

Section 2. BACKGROUND

Section 103(a) of the Internal Revenue Code of 1986 provides that interest on a State or local bond is excludable from gross income. Section 103(b)(2) of the 1986 Code provides however, that interest on an arbitrage bond is not excludable from gross income. Section 148 (a) of the 1986 Code generally provides that a bond is an arbitrage bond if it is part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly to acquire higher yielding investments. A bond is also a arbitrage bond if the issuer intentionally uses the proceeds for this purpose.

Section 1.148-5(b)(2) of the Income Tax Regulations provides that, for purposes of the yield restriction rules of section 148(a) of the 1986 Code, yield is computed separately for each class of investments. For this purpose, in determining the yield on a separate class of investments, the yield on each individual investment with the class is blended with the yield on other individual investments within the class, whether or not held concurrently, by treating those investments as a single investment. Yield restricted non-purpose investments are treated as a separate class of investments.

Section 1.148-5(c) provides that certain payments may be made to the United States to reduce yield on an investment for purposes of section 148(a) of the 1986 Code. Section 1.148-5T(c)(3)(ii) generally provides, however, that yield reduction payments may not be applied to investments allocable to gross proceeds of an advance refunding issue.

Section 1.148-10(g) provides that, notwithstanding any specific provision of sections 1.148-1 through 1.148-11, the Commissioner may take any action, if the Commissioner finds that good faith or other similar circumstances so warrant, consistent with the purposes of section 148 of the 1986 Code.

Section 3. SCOPE

This revenue procedure applies to the determination of the amount of receipts from an investment that is purchased by an issuer on a date when the issuer is unable to purchase SLGS because the Department of the Treasury has suspended sales of SLGS. This revenue procedure applies only to proceeds allocable to an issue of State or local bonds that the issuer on the issue date reasonably expected to reinvest in SLGs having a zero percent yield and that arise from pre-existing yield-restricted investments. This revenue procedure applies for purposes of section 148(a) of the 1986 Code and section 103(c) of the Internal Revenue Code of 1954. References in this revenue procedure to section 148(a) of the 1986 Code include section 103(c) of the 1954 Code.

Section 4. Procedure

01. Conditions to making special yield reduction payments. For purposes of section 148(a), an issuer of State or local bonds may reduce the amount of receipts from an investment (an "alternative investment") purchased with - proceeds of the bonds by the amount of a payment made to the United States if the following requirements are satisfied:

- (1) The alternative investment is purchased on a date when the issuer is unable to purchase SLGS in lieu of the alternative investment because the Department of the Treasury has suspended sales of SLGs.
- (2) The issuer reasonably expected on the issue date of the bonds that it would use bond proceeds to purchase SLGS on a date described in section 4.01(1) of this revenue procedure.
- (3) The maturity date of the alternative investment is not more than 90 days from the date of purchase of the alternative investment.
- (4) The issuer exercises reasonable diligence to use the proceeds of the maturing alternative investment to purchase SLGs, if available, for the remainder of the term that was reasonably expected on the issue date.
- (5) The payment to the United States is made not later than 180 days after the date of purchase of the alternative investment.
- (6) The purchase price of the alternative investment does not exceed the fair market value of the alternative investment, and the issuer maintains books and records relating to the establishment of the purchase price.
- (7) The payment to the United States is equal to the difference between the purchase price of the alternative investment on the date of purchase and the amount of all receipts from the alternative investment.

.02. *Manner of making special yield reduction payments.* Except as otherwise provided in section 4.01 of this revenue procedure, payments made under this revenue procedure must be made in the same manner as yield reduction payments under section 1.148-5T-(c)(2)(1). The following statement should be noted in the top margin of Form 8038-T: “Special Yield Reduction Payment Made Pursuant to Revenue Procedure 95-47.”

Section 5. EFFECTIVE DATE

This revenue procedure applies to a purchase of an investment that occurs on or after October 17, 1995.

DRAFTING INFORMATION

The principal author of this revenue procedure is Loretta J. Finger of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure contact Loretta J. Finger on (202) 622-3980 (not a toll-free call).