



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-106977-18]

RIN 1545-BO77

Arbitrage Investment Restrictions on Tax-Exempt Bonds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the arbitrage investment restrictions under section 148 of the Internal Revenue Code (Code) applicable to tax-exempt bonds and other tax-advantaged bonds issued by State and local governments. The proposed regulations would clarify existing regulations regarding the definition of “investment-type property” covered by arbitrage restrictions by expressly providing an exception for investments in capital projects that are used in furtherance of the public purposes of the bonds. The proposed regulations affect State and local governmental issuers of these bonds and potential investors in capital projects financed with these bonds.

DATES: Comments and requests for a public hearing must be received by **INSERT**

DATE 90 DAYS AFTER THE DATE OF PUBLICATION IN THE FEDERAL

REGISTER].

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-106977-18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours

of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-106977-18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at www.regulations.gov (REG-106977-18).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Spence Hanemann, (202) 317-6980; concerning submissions of comments and requesting a hearing, Regina L. Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

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 Code (Proposed Regulations).

1. In General

In general, under section 103, interest received by holders of eligible bonds issued by State and local governments is exempt from Federal income tax. As a result, tax-exempt State or local bonds generally have lower borrowing costs. To qualify for the tax exemption, State or local bonds must satisfy various eligibility requirements under sections 141 to 150, including the arbitrage investment restrictions under section 148. The arbitrage investment restrictions under section 148 limit the investment of proceeds of tax-exempt bonds in higher yielding investments and require rebate to the Federal government of certain excess earnings on higher yielding investments.

On June 18, 1993, the Department of the Treasury (Treasury Department) 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 (these 1993 regulations and the amendments thereto collectively are referred to as the Existing Regulations).

2. Investment Property Covered by Arbitrage Restrictions

Section 148(a) defines a taxable “arbitrage bond” generally to mean any bond issued as part of an issue any portion of the proceeds of which are reasonably expected to be used or are intentionally used to acquire “higher yielding investments” or to replace funds so used. Section 148(b)(1) defines the term “higher yielding investments” to mean any “investment property” that produces a yield over the term of the issue that is materially higher than the yield on the issue. Section 148(b)(2) defines the term “investment property” to include any security (within the meaning of section 165(g)(2)(A) or (B)), any obligation, any annuity contract, certain residential real property for family units located outside the jurisdiction of the issuer that is financed with bonds other than private activity bonds, and any “investment-type property.”

Section 1.148-1(e)(1) of the Existing Regulations defines a catch-all category of “investment-type property” to include any property (other than securities, obligations, annuity contracts, and covered residential real property for family units under section 148(b)(2)(A), (B), (C), and (E)) “that is held principally as a passive vehicle for the production of income.” For this purpose, §1.148-1(e)(1) of the Existing Regulations provides that the production of income includes any benefit based on the time value of money.

Explanation of Provisions

1. Proposed §1.148-1(e)(4): Exception to Investment-Type Property Definition for Certain Capital Projects

Institutional investors have suggested clarification of the scope of the regulatory definition of investment-type property under §1.148-1(e)(1) to ensure that the definition does not impede greater capital investment in public infrastructure.

The legislative history to the Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2085, indicates that Congress intended to limit the scope of the arbitrage restriction on investment-type property so that it did not extend to investments in capital projects in furtherance of the public purposes of the bonds. In this regard, the House Report to the Tax Reform Act of 1986 included the following statement about the intended scope of the definition of investment-type property: “The restriction would not apply, however, to real or tangible personal property acquired with bond proceeds for reasons other than investment (e.g., courthouse facilities financed with bond proceeds).” H.R. Rep. No. 99-426, at 552 (1985), 1986-3 (vol. 2) C.B. 457; *see also* S. Rep. No. 99-313, at 844 (1986), 1986-3 (vol. 3) C.B. 682 (containing a statement substantially identical to that in the House report); H.R. Rep. No. 99-841, at II-747 (1986) (Conf. Rep.), 1986-3 (vol. 4) C.B. 608 (stating that the conference agreement follows the House bill and the Senate amendment on this restriction).

To clarify the scope of the investment-type property definition consistent with Congressional intent reflected in the legislative history, the Proposed Regulations would provide an express exception to the definition of investment-type property for capital projects that further the public purposes for which the tax-exempt bonds were issued. For example, investment-type property does not include a courthouse financed with

governmental bonds or an eligible exempt facility under section 142, such as a public road, financed with private activity bonds.

2. Applicability Dates and Reliance

The proposed amendments to the definition of investment-type property in the Proposed Regulations are proposed to apply to bonds sold on or after the date that is 90 days after the date of publication of a Treasury Decision adopting these rules as final regulations in the **Federal Register**. Issuers may apply the Proposed Regulations to bonds that are sold before the applicability date provided in a Treasury Decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities.

Comments and Requests for Public Hearing

Before the 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 Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available

at *www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Spence Hanemann of the Office of Associate Chief Counsel (Financial Institutions and Products) and Vicky Tsilas, formerly of the Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the Treasury Department and the IRS 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 continues to read in part as follows:

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

Par. 2. Section 1.148-0(c) is amended by adding entries for §§1.148-1(e)(4) and 1.148-11(n) to read as follows:

§1.148-0 Scope and table of contents.

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(c) * * *

§1.148-1 Definitions and elections.

* * * * *

(e) * * *

(4) Exception for certain capital projects.

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§1.148-11 Effective/applicability dates.

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(n) Investment-type property.

Par. 3 Section 1.148-1 is amended by:

1. Revising the first sentence of paragraph (e)(1).
2. Adding paragraph (e)(4).

The revision and addition read as follows:

§1.148-1 Definitions and elections.

* * * * *

(e) *Investment-type property--(1) In general.* Except as otherwise provided in this paragraph (e), investment-type property includes any property, other than property described in section 148(b)(2)(A), (B), (C), or (E), that is held principally as a passive vehicle for the production of income. * * *

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(4) *Exception for certain capital projects.* Investment-type property does not include real property or tangible personal property (for example, land, buildings, and equipment) that is used in furtherance of the public purposes for which the tax-exempt bonds are issued. For example, investment-type property does not include a courthouse financed with governmental bonds or an eligible exempt facility under section 142, such as a public road, financed with private activity bonds.

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Par. 3. Section 1.148-11 is amended by adding paragraph (n) to read as follows:

§1.148-11 Effective/applicability dates.

* * * * *

(n) *Investment-type property.* Section 1.148-1(e)(1) and (4) apply to bonds sold on or after the date that is 90 days after the date of publication of a Treasury Decision adopting these rules as final regulations in the **Federal Register**.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

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