

Liberty Zone Advance Refunding Notice

Notice 2002-73

PURPOSE

This notice clarifies the circumstances in which a state or local bond is treated as issued by the New York City Municipal Water Finance Authority (NYCMWFA) or the Metropolitan Transportation Authority of the State of New York (MTA) for purposes of § 1400L(e)(2)(B) of the Internal Revenue Code.

BACKGROUND

Section 103(a) provides that, with certain exceptions, gross income does not include interest on any state or local bond.

Section 149(d)(1) provides, in part, that nothing in § 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue described in § 149(d)(3). An issue is described in § 149(d)(3) if any bond (the refunding bond) issued as part of the issue is issued to advance refund a bond unless the refunding bond is only (1) the first advance refunding of the original bond if the original bond is issued after 1985, or (2) the first or second advance refunding of the original bond if the original bond was issued before 1986. Section 149(d)(5) provides that a bond is treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

Section 1400L(e) authorizes one additional advance refunding of certain bonds after March 9, 2002, and before January 1, 2005, notwithstanding the requirements of § 149(d). A bond is eligible for an additional advance refunding under § 1400L(e) only if, among other things, it is described in § 1400L(e)(2). The bonds described in § 1400L(e)(2) include, among others, a state or local bond (other than a private activity bond, as defined in § 141(a)) that was outstanding on September 11, 2001, and that was issued by the NYCMWFA or the MTA.

Section 1.150-1(d)(1) of the Income Tax Regulations provides, in general, that a refunding issue is an issue of obligations (including one or more bonds) the proceeds of which are used to pay principal, interest or redemption price on another issue.

Section 1.150-1(d)(2)(ii)(A) provides, however, that an issue is not a refunding issue to the extent that the obligor of one issue is neither the obligor of the other issue nor a related party with respect to the obligor of the other issue.

Section 1.150-1(d)(2)(ii)(B) provides that the obligor of an issue means the actual issuer of the issue, except that the obligor of the portion of an issue properly allocable to an investment in a purpose investment means the conduit borrower under that purpose investment. Section 1.148-1(b) defines purpose investment as an investment that is acquired to carry out the governmental purpose of an issue. Section 1.150-1(b) provides that a conduit borrower is the obligor on a purpose investment. For example, if an issuer invests proceeds in a purpose investment in the form of a loan, lease, installment sale obligation, or similar obligation to another entity and the obligor uses the proceeds to carry out the governmental purpose of the issue, the obligor is a conduit borrower.

DISCUSSION

Questions have arisen regarding whether a bond that is issued by a state or political subdivision thereof, other than the NYCMWFA (or the MTA), is treated as issued by the NYCMWFA (or the MTA) for purposes of § 1400L(e)(2)(B) if the NYCMWFA (or the MTA) is the obligor of the bond. This notice clarifies that, solely for purposes of § 1400L(e)(2)(B), a state or local bond that is not actually issued by the NYCMWFA (or the MTA) is treated as issued by the NYCMWFA (or the MTA) to the extent that the NYCMWFA (or the MTA) is the obligor of the bond within the meaning of § 1.150-1(d)(2)(ii)(B). For example, if a bond was issued by a state or political subdivision thereof on or before September 11, 2001, and the proceeds of the bond were loaned to the NYCMWFA such that the NYCMWFA is the obligor of the bond within the meaning of § 1.150-1(d)(2)(ii)(B), then the bond is treated as issued by the NYCMWFA solely for purposes of § 1400L(e)(2)(B).

FURTHER INFORMATION

For further information regarding this notice, contact Michael P. Brewer at (202) 622-3980 (not a toll-free call).