



ers of tax-exempt bonds and would provide guidance for complying with the arbitrage regulations.

DATES: Written comments must be received by September 25, 1996. Requests to speak (with outlines of oral comments) at a public hearing scheduled for Thursday, October 24, 1996, at 10 a.m. must be received by October 3, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (FI-28-96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (FI-28-96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. The public hearing will be held in the Commissioner's Conference Room, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Loretta J. Finger, (202) 622-3980; concerning submissions and the hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507).

Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collections of information should be received by August 26, 1996.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information are in proposed § 1.148-5(d)(6)(v), (vi), and (vii). This information is required by the

Notice of Proposed Rulemaking and Notice of Public Hearing

Arbitrage Restrictions on Tax-Exempt Bonds

FI-28-96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations on the arbitrage restrictions applicable to tax-exempt bonds issued by state and local governments. Changes to applicable law were made by the Tax Reform Act of 1986. These proposed regulations affect issu-

IRS to verify compliance with section 148. This information will be used to establish a rebuttable presumption that a Treasury obligation is purchased at fair market value. The likely respondents and/or recordkeepers are state or local governments. Responses to this collection of information are required to establish a rebuttable presumption that a Treasury obligation is purchased at fair market value.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 25 U.S.C. 6103.

Estimated total annual reporting and recordkeeping burden: 2,400 hours. The estimated annual burden per respondent/recordkeeper varies from 2 hours to 30 hours, depending on individual circumstances, with an estimated average of 6 hours.

Estimated number of respondents/recordkeepers: 400.

Estimated annual frequency of responses: on occasion.

Background

This document contains proposed regulations amending the Income Tax Regulations (26 CFR part 1) under section 148 of the Internal Revenue Code to provide guidance on nonpurpose investments for purposes of arbitrage yield restrictions under section 148.

Explanation of Provisions

A. Background of proposed regulations

Section 148 provides rules concerning the use of proceeds of state and local bonds to acquire higher yielding investments. Section 148(a) provides that, except as otherwise permitted by section 148, interest on a state or local bond generally is tax-exempt only if the issuer invests bond proceeds at a yield not exceeding the bond yield. Section 148(f) provides, in general, that interest on a state or local bond is tax-exempt only if the issuer rebates to the United States certain earnings from investing bond proceeds at a yield exceeding the bond yield.

Section 1.148-6(c) provides that gross proceeds of an issue of bonds are not allocated to a payment for a nonpurpose investment in an amount greater than the fair market value of that investment

on the purchase date. For this purpose only, the fair market value of a nonpurpose investment is adjusted to take into account qualified administrative costs allocable to that investment.

Regulations relating to the arbitrage yield restriction rules are in §§ 1.148-0 through 1.148-11 and in §§ 1.148-1T, 1.148-2T, 1.148-3T, 1.148-4T, 1.148-5T, 1.148-6T, 1.148-9T, 1.148-10T, and 1.148-11T. The proposed regulations would clarify and revise certain provisions of these regulations.

B. Bona fide solicitation

Section 1.148-5(d)(6)(iii) provides that the purchase price of a guaranteed investment contract is treated as its fair market value on the purchase date if the issuer makes a bona fide solicitation for a guaranteed investment contract that meets the requirements of that section. The proposed regulations would clarify that a solicitation for a guaranteed investment contract is rebuttably presumed to be bona fide if the following requirements are met: (i) if the issuer uses an agent to conduct the bidding process, the agent does not bid to provide the investment; (ii) all bidders have equal opportunity to bid so that, for example, no bidder is given the opportunity to review other bids (a last look) before bidding; and (iii) all bidders are reasonably competitive providers of investments of the type purchased.

C. Rebuttable presumption for establishing fair market value

Section 1.148-5(d)(6)(iii) provides a safe harbor for establishing fair market value for guaranteed investment contracts. The definition of guaranteed investment contract generally does not include the purchase of investments for an escrow for an advance refunding transaction.

The proposed regulations would provide a rebuttable presumption for establishing fair market value for United States Treasury obligations purchased other than directly from the United States Treasury. The proposed regulations would apply the principles underlying the safe harbor in the regulations for establishing fair market value for guaranteed investment contracts.

D. Qualified administrative costs

Section 1.148-5(e)(2)(i) provides in general that, in determining payments and receipts on nonpurpose investments, qualified administrative costs are taken

into account. Thus, qualified administrative costs increase the payments for, or decrease the receipts from, the investments.

The proposed regulations would provide a special rule to determine qualified administrative costs for United States Treasury obligations purchased other than directly from the United States Treasury.

Proposed Effective Dates

The regulations are proposed to apply to bonds sold on or after the date 60 days after the adoption of final regulations. In addition, these regulations are proposed to apply after that date to permit an issuer to apply these regulations to bonds to which certain other regulations under section 148 apply that were sold prior to that date.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue 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 business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, October 24, 1996, at 10 a.m., in the Commissioner's Conference Room, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by September 25, 1996, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 3, 1996.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Loretta J. Finger, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

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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 as follows:

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

Par. 2. Section 1.148-5 is amended by adding paragraphs (d)(6)(iv) through (d)(6)(viii) and (e)(2)(iv) to read as follows:

§ 1.148-5 Yield and valuation of investments.

* * * * *

(d) * * *

(6) * * *

(iv) *Rebuttable presumption for establishing that a solicitation for a guaranteed investment contract is bona fide.* For purposes of paragraph (d)(6)(iii)(A) of this section, a solicitation for a guaranteed investment contract is rebuttably presumed to be bona fide if the other requirements of paragraph (d)(6)(iii) of this section and the following requirements are satisfied:

(A) If the issuer uses an agent to conduct the bidding process, the agent does not bid to provide the investment;

(B) All bidders have equal opportunity to bid so that, for example, no

bidder is given the opportunity to review other bids (a last look) before bidding; and

(C) All bidders are reasonably competitive providers of investments of the type purchased.

(v) *Rebuttable presumption for establishing fair market value for United States Treasury obligations purchased other than directly from the United States Treasury.* The purchase price of United States Treasury obligations that are purchased other than directly from the United States Treasury is rebuttably presumed to be the fair market value on the purchase date if all of the following requirements are satisfied:

(A) The issuer conducts in good faith a solicitation for the purchase of Treasury obligations that meets the requirements of paragraphs (d)(6)(iv)(A) through (C) of this section, and the issuer receives at least three bona fide bids from providers that have no material financial interest in the issue. For this purpose, underwriters and financial advisors for an issue are considered to have a material financial interest in the issue.

(B) The issuer purchases the highest-yielding Treasury obligations for which a qualifying bid is made.

(C) The yield on the Treasury obligations purchased is not significantly less than the yield then available from the provider on reasonably comparable Treasury obligations offered to other persons for purchase on terms comparable to those offered to the issuer from a source of funds other than gross proceeds of tax-exempt bonds. If closely comparable forward prices are not offered to other persons for purchase from a source other than gross proceeds of tax-exempt bonds, a reasonable basis for this comparison may be by reference to implied forward prices for Treasury obligations based on standard financial formulas. In general, a certificate provided by an agent conducting the bidding process detailing this comparison establishes that this comparability standard is met.

(D) In no event is the yield on any Treasury obligation purchased less than the highest yield then available on a United States Treasury security — State and Local Government Series from the United States Department of the Treasury, Bureau of Public Debt, with the same maturity.

(E) The terms of the agreement to purchase the Treasury obligations are reasonable.

(F) The issuer retains the items enumerated in paragraphs (d)(vi) and (vii) of this section with the bond documents.

(vi) *Copies.* The items described in this paragraph (d)(vi) are a copy of each of the following—

(A) The purchase agreement or confirmation and a statement detailing any oral and other terms of the agreement;

(B) The receipt or other record of the amount actually paid by the issuer for the Treasury obligations, including a statement setting out the amount of any brokerage commission, broker fee, or bidding fee paid to or by the seller of the Treasury obligations; and

(C) Each bid that is received with respect to the solicitation of the Treasury obligations (clearly stamped to show date and time when the bid was received) and a description of the bidding procedure used.

(vii) *Statement.* The item described in this paragraph (d)(vii) is a statement from the issuer, dated as of the issue date of the bonds, certifying, under penalties of perjury, that—

(A) If the issuer used an agent to conduct the bidding process, the agent did not bid to provide the investment;

(B) All bidders had equal opportunity to bid so that, for example, no bidder had an opportunity to review other bids before bidding;

(C) All bidders are reasonably competitive sellers of Treasury obligations; and

(D) The issuer received at least three bona fide bids from providers that have no material financial interest in the issue. (viii) For purposes of paragraphs (d)(6)(v) through (vii) of this section, the term *issuer* means only the entity that actually issues the bonds and not a conduit borrower of the issuer.

(e) * * *

(2) * * *

(iv) *Special rule for United States Treasury obligations purchased other than directly from the United States Treasury.* For Treasury obligations purchased other than directly from the United States Treasury, a fee paid to a bidding agent is a qualified administrative cost only if the following requirements are satisfied:

(A) The fee must be reasonable. In general, a fee must be separately stated in order for the issuer to have a basis for determining that a fee is reasonable. The fee is presumed to be reasonable if it does not exceed .02 percent of the amount invested in Treasury obligations.

(B) The fee must be comparable to a fee that would be charged for a reasonably comparable investment of Treasury obligations if acquired with a source of funds other than gross proceeds of tax-exempt bonds. This comparability standard must be applied even if no identical investments are customarily acquired with a source of funds other than gross proceeds of tax-exempt bonds. In general, reference must be made to the bidding fees paid by investors that are not issuers of tax-exempt bonds in those transactions that are most closely comparable to the purchase of investments by the issuer of tax-exempt bonds. For example, reference to the bidding fees generally paid for the purchase of forward contracts for Treasury obligations is ordinarily a reasonable method of determining whether bidding fees are reasonable.

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Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 27, 1996, 61 F.R. 33405)