

## **Module E**

# **IRC Section 142 - Exempt Facility Bonds**



## Module E

### IRC Section 142 - Exempt Facility Bonds

#### Overview

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**Introduction** Module D discussed the private activity bond tests. In that lesson, you learned that if a bond met the private business tests or the private loan financing test, then it was a private activity bond. You know from Module B that the interest on private activity bonds is not tax exempt (under IRC section 103(b)(1)), unless the bonds are **qualified** private activity bonds.

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**What is a Qualified Private Activity Bond?** The definition of a **qualified** private activity bond is found in IRC section 141(e) and provides that:

1. The bond must be one of the following types:
    - an exempt facility bond (section 142(a)),
    - a qualified mortgage bond (section 143(a)),
    - a qualified veterans mortgage bond (section 143(b)),
    - a qualified small issue bond (section 144(a)),
    - a qualified student loan bond (section 144(b)),
    - a qualified redevelopment bond (section 144(c)), OR
    - a qualified 501(c)(3) bond (section 145),
  2. The applicable requirements of IRC section 146 (volume cap) must be met, AND
  3. The applicable requirements of IRC section 147 must be met.
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**Other Requirements of a Qualified Private Activity Bond** Let's not forget that even though a bond meets the definition of a qualified private activity bond, it must still meet the other requirements of IRC sections 103(a) and (b), in order for the interest to be tax-exempt.

You will recall that these other requirements are:

- the bonds cannot be arbitrage bonds, AND
  - the bonds must meet all of the applicable requirements of IRC section 149.
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## Overview, Continued

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### **Preview of Modules E through H**

With this in mind, Modules E through I discuss the various types of qualified private activity bonds. Each type has specific requirements that must be met under the section in which it is described.

Module E begins with a discussion of exempt facility bonds, as described in IRC section 142.

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### **Objectives**

At the end of this lesson, the student will be able to:

- Identify and define each type of facility included in the definition of “exempt facility.”
  - Explain the requirements of ALL exempt facility bonds.
  - Describe the special requirements of each type of exempt facility bond.
  - Identify rules found in other sections of the Code that apply to exempt facility bonds.
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## Overview, Continued

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**In This Module** This module contains the following topics:

<b>Topic</b>	<b>See Page</b>
Overview	E-1
Introduction to Exempt Facility Bonds	E-4
Section 1: Airport Facilities	E-7
Section 2: Docks and Wharves	E-11
Section 3: Mass Commuting Facilities	E-13
Section 4: High-Speed Intercity Rail Facilities	E-15
Section 5: Qualified Residential Rental Projects	E-17
Section 6: Facilities for Furnishing Water	E-28
Section 7: Sewage Disposal Facilities	E-30
Section 8: Solid Waste Disposal Facilities	E-32
Section 9: Facilities for the Local Furnishing of Electrical Energy or Gas	E-36
Section 10: Local District Heating or Cooling Facility	E-40
Section 11: Qualified Hazardous Waste Disposal Facilities	E-41
Section 12: Environmental Enhancement of Hydroelectric Generating Facilities	E-42
Section 13: Auditing Techniques	E-43
Summary	E-44
Exhibits	E-46

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# Introduction to Exempt Facility Bonds

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## **Definition of Exempt Facility Bond**

An exempt facility bond is any bond issued pursuant to IRC section 142, at least 95 percent of the net proceeds of which are used, **or to be used**, to finance the following facilities (“exempt facilities”):

- airports,
  - docks and wharves,
  - mass commuting facilities,
  - facilities for furnishing of water,
  - sewage facilities,
  - solid waste disposal facilities,
  - qualified residential rental facilities,
  - facilities for local furnishing of electric energy or gas,
  - facilities for local district heating and cooling,
  - qualified hazardous waste facilities,
  - high-speed intercity rail facilities, OR
  - environmental enhancements of hydroelectric generating facilities.
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## **Statutory Provisions**

The specific requirements for exempt facility bonds are provided in IRC section 142.

Prior to the Tax Reform Act of 1986, the following facilities were considered exempt facilities:

- sports facilities,
- convention and trade show facilities,
- parking facilities, AND
- pollution control facilities.

High-speed intercity rail facilities were added by the Technical and Miscellaneous Revenue Act of 1988.

Other requirements applicable to qualified private activity bonds, which are also applicable to exempt facility bonds are provided in IRC sections 146-150.

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## **Regulations**

Treas. Reg. sections 1.103-8, 1.103-9, 1.141-7T and 8T, 1.141-15T, 1.141-16, 1.142-1, 1.142-2, 1.142(f)(4)-1T, and 1.150-5T provide rules applicable to certain exempt facility bonds.

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## Introduction to Exempt Facility Bonds, Continued

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**Use of Proceeds** At least 95 percent of the net proceeds of the bonds (bond proceeds less amounts in the reasonable required reserve fund) must be used to finance the facilities described in IRC section 142(a).

Prior to the 1986 Act, “substantially all” of the proceeds of the bonds had to be used to finance exempt facilities. **(See section 103(b)(4) of the 1954 Code.)**

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**Substantially All (for pre-1986 Bonds)**

Treas. Reg. section 1.103-8(a)(1) provides that substantially all of the proceeds are used to provide an exempt facility if 90 percent or more of such proceeds are so used.

To determine “substantially all,” two rules apply:

- the proceeds are reduced by amounts properly allocable on a pro rata basis between providing the exempt facility and other uses of proceeds, AND
- amounts used to provide an exempt facility include amounts paid which are properly chargeable to the facility’s capital account.

### **Example 1**

In Rev. Rul. 77-122, 1977-1 CB 23, the Service ruled that 11 percent of the bond proceeds were used to reimburse prior construction expenditures and were not valid costs of the facilities. Accordingly, the “substantially all” requirement was not met.

### **Example 2**

In Rev. Rul. 80-171, 1980-2 CB 44, in determining whether “substantially all” of the proceeds of the bonds (100x) are used for qualifying costs, the Service ruled that proceeds are first reduced by costs of issuance (5x) and amounts deposited in the reserve fund (15x). Because 90 percent of 80x (100x less 5x less 15x) were used for qualifying costs, the “substantially all” requirement was met.

**(However, see Rev. Rul. 90-51, 1990-1 CB 22, which made Rev. Rul. 80-171 obsolete with respect to exempt facility bonds issued after August 15, 1986 (subject to transitional rules contained in sections 1312-1318 of the TRA 1986), as amended by section 1013 of the Technical and Miscellaneous Revenue Act of 1988, P.L. No. 100-647, 102, Stat. 3537.)**

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## Introduction to Exempt Facility Bonds, Continued

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**Substantially All (for pre-1986 Bonds), continued**

See also **Rev. Rul. 79-332, 1979-2 CB 38**, where the “substantially all” requirement was not met.

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**Public Use**

To qualify as an exempt facility under IRC section 142, a facility must serve or be available on a regular basis for general public use, OR be part of a facility which is so used. **(See Treas. Reg. section 1.103-8(a)(2).)**

Treas. Reg. section 1.141-3(c), which applies to bonds issued after May 16, 1997, provides that use of financed property by nongovernmental persons in their trade or business is treated as general public use only if the property is intended to be available, and in fact is reasonably available, for use on the same basis by natural persons not engaged in a trade or business.

Use under an arrangement that conveys priority rights or other preferential benefits is not used on the same basis as the general public.

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# Section 1

## Airport Facilities

### General Rules

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**Definition** Airport facilities are facilities which are directly related and essential to:

- servicing aircraft or enabling aircraft to take off and land, OR
- transferring passengers or cargo to or from aircraft. (**See Treas. Reg. section 1.103-8(e)(2).**)

The facility must be located at, or in close proximity to, the take-off and landing area in order to perform its functions. (**See Treas. Reg. section 1.103-8(e)(2)(ii)(a).**)

The examples provided in the regulations of airport facilities are:

- terminals, runways, hangars, loading facilities, repair shops, AND
- land-based navigation aids, such as radar installation.

Limitations apply regarding the financing and use of certain facilities. These limitations are discussed below.

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**Public Use** Treas. Reg. section 1.103-8(a)(2) provides that the facilities must satisfy the public use requirement. The facility must serve or be available on a regular basis for general public use or be part of a facility that is so used. (**See also Treas. Reg. section 1.141-3(c).**)

A hangar or repair facility at a municipal airport will qualify as a facility for general public use even if it is owned by, leased, or permanently assigned to a private person, provided that such facility services the general public, such as a common passenger carrier or freight carrier.

An airport owned or operated by a nonexempt person for general public use is a facility for public use. However, a landing strip which by reason of a formal or informal agreement or by reason of geographic location, which will not be reasonably available for general public use does not satisfy the public use requirement.

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## Airport Facilities, Continued

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### Functionally Related and Subordinate Facilities

Treas. Reg. section 1.103-8(a)(3) provides that an exempt facility includes any land, building, or other property functionally related and subordinate to such facility.

Treas. Reg. section 1.103-8(e)(2)(ii)(b) provides that a facility (or a part thereof) is not functionally related and subordinate to an airport if the facility (or a part thereof):

- is NOT of a character and size commensurate with the character and size of the airport or adjacent to which the facility is located, OR
- is NOT located at or adjacent to that airport.

The regulations provide examples of facilities that are considered functionally related and subordinate to an airport.

#### **Example 1**

Facilities used primarily for the manufacture and modification of aircraft in the immediate vicinity of an airport do not qualify as facilities that are functionally related and subordinate to the airport. (See **Rev. Rul. 77-324, 1977-2 CB 37**)

#### **Example 2**

A 270-room hotel located within  $\frac{1}{4}$  of a mile of an airport's main terminal, which will have less than 10 percent of its square footage used as meeting space qualified as functionally related and subordinate to the airport. The airport had a restaurant, pub/lounge, a lobby lounge, and a spa and whirlpool. (See **PLR 8634008 and note that this ruling letter was issued before August 15, 1986**)

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## Airport Facilities, Continued

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### Changes After the 1986 Act

IRC section 142(c)(2) provides that the term “airport” does not include any of the following facilities if used for any private business use:

- hotels (or other lodging facilities),
  - retail facilities (including food and beverage facilities) located in a terminal, if the facilities are in excess of a size necessary to serve passengers and employees at the airport,
  - retail facilities for passengers or the general public (including, but not limited to rental car lots) located outside the terminal,
  - office buildings for individuals who are not employees of a governmental unit or of the public airport operating authority, OR
  - industrial parks or manufacturing facilities.
- 

### Mixed Use Airport Facilities

In determining the portion of costs of mixed-use airport facilities financed with tax-exempt bonds, cost of the portions that do NOT qualify as “airport facilities” include only:

- the structural components required for the nonqualifying portion, such as:
  - interior walls,
  - partitions,
  - ceilings, AND
  - special enclosures; AND
- the interior furnishings of the nonqualifying facilities, such as:
  - additional plumbing,
  - electrical, AND
  - decorating costs.

Cost of the general components of the terminal or other airport facility, such as land, structural supports, and exterior walls, are NOT required to be allocated to nonqualifying portions. However, to be excluded from the nonqualifying portions, these general components must be required for the qualifying portion of the airport facilities.

**(See H.R. Rep. No. 99-426, 99<sup>th</sup> Cong., 1<sup>st</sup> Sess., December 7, 1985, page 528)**

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## General Rules, Continued

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**Governmental Ownership** IRC section 142(b)(1)(A) provides that to qualify as an exempt facility, the airport facility financed with proceeds of bonds must be owned by a governmental unit.

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**Safe Harbor** IRC section 142(b)(1)(B) provides a safe harbor for determining governmental ownership in cases of leases or management contracts if:

- the lessee makes an irrevocable election not to claim depreciation or an investment credit with respect to the property,
- the lease term is not more than 80 percent of the reasonably expected economic life of the property, AND
- the lessee has no option to purchase the property other than at fair market value.

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**Limitation on Office Space** An office is not included in the definition of “airports” under IRC section 142(a) unless:

- it is located on the premises of the airport, and
- not more than a de minimis amount of the functions performed at the office are unrelated to the day-to-day operations of the airport.

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**Storage or Training Facilities** Under IRC section 142(c)(1), storage or training facilities directly related to an airport are treated as “airport facilities.”

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**Other Requirements** The private activity bond rules stated in IRC sections 147(a) through (g) and 150(b)(4) are applicable to bonds issued to finance airports under IRC section 142(a)(1). The rules of IRC section 148 and 149 also apply to bonds issued to finance airports.

IRC section 146(g)(3) provides that no volume cap allocation is required for bonds issued to finance airports.

These rules are discussed in other modules of this text.

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## Section 2

### Docks and Wharves

#### General Rules

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**Definition** Exempt facility bonds may be issued to finance docks and wharves and their related storage or training facilities.

**Example 1**

Facilities to store and handle shipping oil owned by a corporation qualified as dock and wharves in Rev. Rul. 79-385, 1979-2 CB 40. The facilities were part of a larger system for interstate transportation of oil. The corporation was subject to Interstate Commerce Commission regulations and was required to accept offers from any oil producer for transportation through the dock and wharf facilities. Because the facility was available to other oil producers, the ruling held that the public use requirement had been met.

(See also Rev. Rul. 78-247, 1978-1 CB 29.)

**Example 2**

In Rev. Rul. 77-233, 1977-2 CB 30, the Service held that a dry dock located in a public port and used for repair and maintenance qualified as an exempt facility. The dry dock was of adequate size to repair all ships using the port and was open to the general public.

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**Public Use** Treas. Reg. section 1.103-8(a)(2) provides that the facilities must satisfy the public use requirement. The facility must serve or be available on a regular basis for general public use. (See also Treas. Reg. section 1.141-3(c).)

A private dock or wharf owned by or leased to, and serving only a single manufacturing plant would not qualify as a facility for general public use. However, if the private owner or lessee of such dock or wharf serves the general public, such as a common passenger or freight carrier, the facility will be considered to be in general public use.

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## Docks and Wharves, Continued

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### Functionally Related and Subordinate Facilities

Treas. Reg. section 1.103-8(a)(3) provides that an exempt facility includes any land, building, or other property functionally related and subordinate to such facility. To be considered functionally related and subordinate, the facility should be of a character and size commensurate with the character and size of the dock or wharf OR adjacent to it.

Treas. Reg. section 1.103-8(e)(2)(d)(iii) provides examples of functionally related and subordinate facilities, such as:

- the equipment needed to receive and to discharge cargo and passengers from the vessel,
- cranes and conveyors, AND
- related storage, handling, office, and passenger areas.

After the 1986 Act, functionally related and subordinate facilities specifically do NOT include facilities that are used in private business use. **(See H.R. Rep. No. 99-426, 99<sup>th</sup> Cong., 1<sup>st</sup> Sess., December 7, 1985, page 529, and the prior section of this text regarding airports.)**

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### Other Requirements

The governmental ownership requirement of section 142(b)(1) is applicable. The same safe harbors regarding leases and management contracts apply to docks and wharves as to airports.

Treatment of mixed-use facilities is the same as that for airports. **(See H.R. Rep. No. 426, 99<sup>th</sup> Cong., 1<sup>st</sup> Sess., December 7, 1985, page 529.)**

The private activity bond rules stated in IRC sections 147(a) through (g) and 150(b)(4) are applicable to bonds issued to finance docks and wharves under IRC section 142(a)(2). The arbitrage and rebate rules of IRC section 148 and the rules of IRC section 149 also apply to these bonds.

IRC section 146(g)(3) provides that NO volume cap allocation is required for bonds issued to finance docks and wharves.

These rules are discussed in other modules of this text.

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## Section 3

### Mass Commuting Facilities

#### General Rules

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**Definition** IRC section 142(a)(3) permits financing of mass commuting facilities and related storage and training facilities with proceeds of tax-exempt bonds.

Mass commuting facilities do not include mass commuting vehicles. **(See Rev. Rul. 88-51, 1982-1 CB 74.)**

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**Public Use** Treas. Reg. section 1.103-8(a)(2) provides that the facilities must satisfy the public use requirement. The facility must serve or be available on a regular basis for general public use. **(See also Treas. Reg. section 1.141-3(c).)**

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**Functionally Related and Subordinate Facilities** Treas. Reg. section 1.103-8(a)(3) provides that an exempt facility includes any land, building, or other property functionally related and subordinate to such facility. To be considered functionally related and subordinate, the facility should be of a character and size commensurate with the character and size of the mass commuting facility OR adjacent to it.

Treas. Reg. section 1.103-8(e)(2)(d)(iv) states that functionally related and subordinate facilities include real property together with improvements, and personal property used in the facility, such as machinery, equipment, and furniture, serving the general public commuting on a day-to-day basis.

After the 1986 Act, functionally related and subordinate facilities specifically do NOT include facilities that are used in private business use. **(See H.R. Rep. No. 99-426, 99<sup>th</sup> Cong., 1<sup>st</sup> Sess., December 7, 1985, page 529.)**

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## Mass Commuting Facilities, Continued

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### **Other Requirements**

The governmental ownership requirement of IRC section 142(b)(1) is also applicable. The same safe harbors regarding leases and management contracts that apply to airports apply to mass commuting facilities.

Treatment of mixed-use facilities is the same as that for airports. **(See H.R. Rep. 426, 99<sup>th</sup> Cong., 1<sup>st</sup> Sess., December 7, 1985, page 530.)**

Private activity bond rules stated in IRC sections 146, 147(a) through (g), and 150(b)(4) are applicable to bonds issued to finance mass commuting facilities under IRC section 142(a)(3). The arbitrage and rebate rules of IRC section 148 and the rules of IRC section 149 also apply to these bonds.

These rules are discussed in other modules of this text.

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## Section 4

### High-Speed Intercity Rail Facilities

#### General Rules

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**Definition** IRC section 142(i)(1) defines high-speed intercity rail facilities as any facility (not including rolling stock) for fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas using vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour between scheduled stops.

The facilities must be available for use by the general public as passengers.

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**Governmental Ownership** IRC section 142(i)(2) states that for high-speed intercity rail facilities to qualify as exempt facilities, they must either:

- be owned by a governmental unit, OR
- the owner of the facility must irrevocably elect NOT to claim any depreciation deduction or investment tax credit with respect to the property financed.

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**Public Use** Treas. Reg. section 1.103-8(a)(2) provides that the facilities must satisfy the public use requirement. The facility must serve or be available on a regular basis for general public use. **(See also Treas. Reg. section 1.141-3(c))**

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**Use of Proceeds** IRC section 142(i)(3) provides that for the bonds to qualify as tax-exempt bonds, any proceeds of the bonds NOT used within a three-year period from the date of issuance of the bonds must be used to redeem the bonds. The redemption must occur within six months after the end of this three-year period.

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## High-Speed Intercity Rail Facilities, Continued

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### **Other Requirements**

The private activity bond rules stated in IRC sections 147(a) through (g) and 150(b)(4) are applicable to bonds issued to finance high-speed intercity rail facilities under IRC section 142(a)(11). The rules of IRC sections 148 and 149 also apply to these bonds. These rules are discussed in other modules of this text.

Regarding the volume cap, IRC section 146(g)(4) provides that no private activity bond allocation is required for 75 percent of the issue, but allocation is required for the remaining 25 percent, if the property is NOT owned by a governmental unit.

If all of the bond-financed property is owned by a governmental unit, no private activity bond allocation is required.

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## Section 5

### Qualified Residential Rental Projects

#### Introduction

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**Definition** The term “qualified residential rental project” means a project for residential rental property that, at all times during the qualified project period, meets the set aside requirements of IRC sections 142(d)(1)(A) or (B).

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**In this Section** This section contains the following topics:

Topic	See Page
Introduction	E-17
Residential Rental Property	E-18
Income Requirements	E-22
Qualified Project Period	E-25
Other Requirements	E-27

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## Residential Rental Property

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### What is a residential rental project?

A residential rental project is a building or structure, which together with any functionally related and subordinate facilities, contains one or more similarly constructed units that are:

- used for other than a transient basis, AND
- available to the general public.

Hotels, motels, dormitories, fraternity and sorority houses, rooming houses, hospital, nursing homes, sanitariums, rest homes, and trailer parks and courts are considered to be used on a transient basis and are NOT residential rental property. **(See Treas. Reg. section 1.103-8(b)(4).)**

Rev. Rul. 98-47, 1998-39 I.R.B. 4, **(Exhibit E-1)** describes residential rental property for purposes of IRC sections 142(d) and 145(d). The ruling discusses three types of living accommodations.

1. apartments without any services other than basic services like laundry and housekeeping,
2. apartments with these basic services plus assisted-living services, or
3. apartments with frequent nursing, medical or psychological services.

The Revenue Ruling holds that the first two types of apartments are residential rental housing, while the third type is not.

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### Building or Structure

A building or structure is a discrete edifice or other man-made construction consisting of an independent foundation, outer walls, and a roof. **(See Treas. Reg. section 1.103-8(b)(8)(iv).)**

Single townhouses are not buildings if the foundation and outer walls and roofs are not independent. Detached townhouses and rowhouses would be considered buildings.

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## Residential Rental Property, Continued

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### Units

Any accommodation containing separate and complete facilities for living, sleeping, eating, cooking, and sanitation. The accommodations may be served by a centrally located heating and air-conditioning equipment.

For example, an apartment containing a living area, a sleeping area, bathing and sanitation facilities, and cooking facilities equipped with a cooking range, refrigerator, and sink, all of which are separate and distinct from other apartments, would constitute a unit. (See **Treas. Reg. section 1.103-8(b)(8)(i).**)

#### **Example 1**

In PLR 8221149, the Service ruled that the project was not a residential rental project because the kitchenettes in each unit were not intended for regular day-to-day cooking. The units were located in a retirement center and meals and other services were provided by the center to the residents and charges were imposed for such meals and services.

(But see Rev. Rul. 98-47 which holds that apartments are residential rental housing even though the residents were entitled to eat in a common dining facility in exchange for rent.)

#### **Example 2**

In PLR 8308051, the Service concluded that the facility was not a residential rental project. Although each unit had a small sink and stove, the residents had to use toilets in a common area.

#### **Example 3**

In PLR 9711021, the Service concluded that based on the particular circumstances of the case, the project, which would accommodate non-transient residents with disabilities, was a residential rental project. Most of the units in the project had a sink, a cooking range, and a full-size refrigerator. However, some of the units contained a small refrigerator and a microwave oven instead of a cooking range.

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## Residential Rental Property, Continued

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### **Owner-Occupied Residences**

A residential rental project does not include any building or structure that contains fewer than five units, one of which is occupied by an owner of the units.

A cooperative housing project is not a qualified residential project where half of the units are owned by the shareholders of the cooperative and the other half are rented. **(See Example 3 of Treas. Reg. section 1.103-8(b)(9).)**

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### **Public Use**

The units must be legally and practically available to the members of the general public. Units are not available to the general public if they are provided only for members of a social organization or a particular employer's employees.

A building that is constructed adjacent to a factory, and the factory employees are given preference in selecting tenants is not available to the general public. **(See Example 2 in Treas. Reg. section 1.103-8(b)(9).)**

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### **Multiple Buildings**

Buildings and structures are part of the same project if they:

- are proximate to one another,
  - have similarly constructed units,
  - are owned by the same person, for purposes of federal income tax, AND
  - are financed pursuant to a common plan.
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### **Proximate**

Buildings and structures are proximate to one another if they are located on a single tract of land, i.e., any parcel or parcels of land that are contiguous except for the imposition of a road, street, stream, or similar property.

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### **Common Plan of Finance**

The same criteria as stated in Treas. Reg. section 1.150-1T(c)1(ii) apply.

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## Residential Rental Property, Continued

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### **Functionally Related and Subordinate Property**

Treas. Reg. section 1.103-8(b)(4)(iii) provides that functionally related and subordinate property to residential rental projects includes facilities for use by tenants, such as:

- swimming pools,
  - other recreational facilities,
  - parking areas, AND
  - other facilities reasonably required for the project, such as:
    - heating and cooling equipment,
    - trash disposal equipment, OR
    - units for resident managers or maintenance personnel.
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# Income Requirements

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- Set-asides** For a residential rental project to qualify under IRC section 142(d), it must meet one of the following tests:
- at least 20 percent of the units in the project must be occupied by individuals and families whose income is 50 percent or less of the area median gross income (the “20-50 test”), OR
  - at least 40 percent of the units in the project must be occupied by individuals and families whose income is 60 percent or less of the area median gross income (the “40-60 test”).

The income requirements are also referred to as “set-aside” requirements.

Once 10 percent of the units in the project are occupied, 20 percent of the units must be occupied by individuals or families of low or moderate income elected by the issuer. The income requirements must be maintained during the initial period when the project is being fully rented.

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- Election** The owner of the project must irrevocably elect at the time of issuance of the bonds which test will be used. The election must be made in the bond documents.
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- Determination of Income** Individual and family income is determined in a manner consistent with determinations of lower income facilities and area median gross income under Section 8 of the US Housing Act of 1937 **(See IRC section 142(d)(2)(B).)**

**Exhibit E-2** shows a sample of HUD income determinations.

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- Adjustment for Family Size** Area median incomes are also adjusted for family size in accordance with Section 8 of the Housing Act. **(See IRC section 142(d)(2)(B).)**

At page 1172, the Blue Book provides that, if a project qualifies under the 20-50 test, adjustments for family size are made to determine if families are low or moderate income. As shown in the table below, a family of four generally is treated as having low or moderate income if the family has an income of 50 percent or less of the area median gross income.

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## Income Requirements, Continued

**Adjustment for Family Size, continued**

Family size	Family income as a percent of area median gross income
1	35 percent or less
2	40 percent or less
3	45 percent or less
4	50 percent or less

**Adjustment for Family Size, continued**

Similar 10 percent reductions are made to family income if the 40-60 set-asides are used.

**Annual Income Determinations**

IRC section 142(d)(3) provides that the determination that the income of a resident meets the income tests elected by the owner must be made at least annually on the basis of the current income of the residents.

If the resident's income increases or the family size decreases, the project may not meet the set-aside requirements.

**Increase in Resident's Income**

IRC section 142(d)(3)(B) provides that if at the time the resident first occupied the unit the project met the set-aside requirements, then the resident is deemed to meet the low or moderate income requirement.

**Maintenance of Income Requirements After Increase of Income**

However, once a resident's income exceeds 140 percent of the applicable income limit, no residential unit of comparable or smaller size in the project may be occupied by a new resident whose income exceeds the applicable income limit. The next available comparably sized or smaller unit must therefore be rented to a resident meeting the set-aside income requirements. **(See IRC section 142(d)(3)(B).)**

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## Income Requirements, Continued

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### Deep Rent Skewed Project

IRC section 142(d)(4) provides that the owner of a project may elect to satisfy an alternate set-aside requirement:

- at least 15 percent of the low-income units in the project must be occupied by tenants whose income is 40 percent or less of the area median income,
- the gross rent of each low-income unit in the project does not exceed 30 percent of the applicable income limit which applies to individuals occupying the unit, AND
- the gross rent of each low-income unit in the project does not exceed 50 percent of the average gross rent of units of comparable size which are not occupied by individuals who meet the applicable income limit.

If the income of a qualifying resident exceeds 170 percent of the applicable limit, the next available comparable size unit must be occupied by a new resident whose income does not exceed 40 percent of the area median gross income.

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### Gross Rent

For purposes of a deep rent skewed project, gross rent means any payment under section 8 of the Housing Act and any utility allowance that are paid from the resident's rent. **(See IRC section 142(d)(4)(C)(ii).)**

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### Annual Certification

IRC section 142(d)(7) requires the owner of the project to certify annually that the income requirements for the project are satisfied. The owner makes this certification by filing **Form 8703, Annual Certification by Operator of a Residential Rental Project**. The failure on the part of the owner to certify will not cause the bonds to become taxable. However, the owner will be subject to a penalty of \$100 for each failure to certify under IRC section 6652(j).

Form 8703 is due by March 31 after the close of the calendar year for which the certification is made. **(See Exhibit E-3 for Form 8703.)**

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## Qualified Project Period

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### Definition

The table below defines the qualified project period: (See IRC section 142(d)(2)(A).)

Beginning Date	Ending Date
First day that 10 percent of residential units are occupied	The latest of: <ul style="list-style-type: none"><li>• 15 years after the date that 50 percent of the units are occupied,</li><li>• the first day that no tax-exempt private activity bond issued for the project is outstanding, OR</li><li>• the date that any assistance for the project under section 8 of the US Housing Act of 1937 terminates.</li></ul>

---

### Effect of Noncompliance

Treas. Reg. section 1.103-8(b)(6) provides that, unless corrected within a reasonable period, noncompliance with the set-aside requirements during the qualified project period will cause the bonds to become taxable from the date of issue.

If the issuer corrects noncompliance within a reasonable period (60 days) after the error is discovered, such noncompliance will not cause the bonds to become taxable.

If the issuer fails to correct noncompliance within a reasonable time, but makes a correction after such time, the project will still be deemed to be in noncompliance, and the bonds will be taxable from the date of issuance.

### Example 1

County Z issues bonds in 1987 and loans the proceeds to Corporation X to construct a residential rental project. On the date of issuance of the bonds County Z elects that 20 percent of the units at the project will be occupied by persons having income of 50 percent or less of the area median income. In 1991 less than 20 percent of the units are occupied by residents meeting the applicable income criteria. County Z has failed to enforce these requirements. The bonds will be taxable from the date of issuance.

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*Continued on next page*

## Qualified Project Period, Continued

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**Effect of  
Noncompliance  
(continued)**

**Example 2**

On January 15, 1987, State Z issues bonds with a term of 15 years to acquire and renovate a residential rental project to be owned by Corporation X. On June 1, 1988, the first resident occupies a unit at the project. On July 1, 1988, at least 50 percent of the units are occupied. On January 15, 1991, State Z issues refunding bonds to refund the bonds. The refunding bonds have a stated maturity date of January 15, 2003. The prior bonds are retired on March 15, 1991. To qualify as a qualified residential rental project under section 142(d), the project must meet the income requirements until July 1, 2003.

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## Other Requirements

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### **Private Activity Bond Rules**

The following private activity bond rules are applicable to bonds issued to finance residential rental projects under IRC section 142(d):

- IRC section 146 requires that before issuance of the bonds the issuer receive volume cap allocation for the issue.
- IRC section 147(a) provides that a private activity bond will NOT be a qualified bond for any period during which it is held by a person who is a substantial user of the facility or a related person of the substantial user.
- IRC section 147(b)(1) places a limit on the average maturity of the bonds.
- IRC section 147(c) limits the amount of bond proceeds which may be used to acquire land.
- IRC section 147(d) prohibits the acquisition of existing property unless the first use of such property is pursuant to such acquisition.
- IRC section 147(e) prohibits the use of bonds to finance certain facilities.
- IRC section 147(f) provides the notice and public approval requirements.
- IRC section limits the amount of bond proceeds which may be used for costs of issuance.
- IRC section 148 provides rules regarding arbitrage and rebate.
- IRC section 149 provides various rules for all private activity bonds.
- The requirements of IRC section 150(b)(2) regarding change of use apply.

These rules are discussed in other modules of this text.

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## Section 6

### Facilities for Furnishing Water

#### General Rules

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**Definition** A facility is described in IRC section 142(a)(4) if:

- the water is or will be made available to members of the general public, AND
- either the facility is operated by a governmental unit or the rates for the furnishing or sale of water have been established or approved by a state or political subdivision thereof.

General public includes electric utility, industrial, agricultural, or commercial users.

Artesian wells, reservoirs, dams, related equipment and pipelines, and other facilities used to furnish water for domestic, industrial, irrigation, or other purposes, are included as “water facilities.” (See **Treas. Reg. section 1.103-8(h)(2).**)

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**Public Use** Treas. Reg. section 1.103-8(a)(2) provides that the facility must satisfy the public use requirement. Under Treas. Reg. section 1.103-8(h)(1), a water facility will satisfy the public use test if it will provide water on reasonable demand, to any member of the general public within the service area of the water system of which the facility is a part.

Use by one or more private persons of 80 percent of the output of a water facility does not meet the public use requirement. (See **Rev. Rul. 76-494, 1976-2 CB 26.**) Even if the facility serves a large number of members of the general public, if a large portion of the facility’s output is used by a private person, the facility will not meet the requirements of IRC section 142(e) and Treas. Reg. section 1.103-8(h)(1).

(See also **Rev. Rul. 78-21, 1978-1 CB 26.**)

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*Continued on next page*

## Facilities for Furnishing Water, Continued

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### **Irrigation Facility Does Not Qualify**

In PLR 9220036, the Service ruled that bonds issued to finance irrigation equipment to be leased to farmers in a conservation district will not qualify. The facility would not qualify as a “facility for the furnishing of water” as described in IRC section 142(a)(4).

---

### **Other Requirements**

The following private activity bond rules are applicable to bonds issued to finance facilities for furnishing water under IRC section 142(a)(4):

- IRC section 146 requires that before issuance of the bonds the issuer receive volume cap allocation for the issue.
- IRC section 147(a) provides that a private activity bond will NOT be a qualified bond for any period during which it is held by a person who is a substantial user of the facility or a related person of the substantial user.
- IRC section 147(b)(1) places a limit on the average maturity of the bonds.
- IRC section 147(c) limits the amount of bond proceeds which may be used to acquire land.
- IRC section 147(d) prohibits the acquisition of existing property unless the first use of such property is pursuant to such acquisition.
- IRC section 147(e) prohibits the use of bonds to finance certain facilities.
- IRC section 147(f) provides the notice and public approval requirements.
- IRC section limits the amount of bond proceeds which may be used for costs of issuance.
- IRC section 148 provides rules regarding arbitrage and rebate.
- IRC section 149 provides various rules for all private activity bonds.
- The requirements of IRC section 150(b)(4) regarding change of use apply.

These rules are discussed in other modules of this text.

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## Section 7

### Sewage Disposal Facilities

#### General Rules

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**Definition** The Code does not define a sewage disposal facility.

Treas. Reg. section 1.142(a)(5)-1 defines a sewage disposal facility as property at least 95 percent of the bond proceeds are used for the collection, storage, treatment, utilization, processing, OR final disposition of sewage.

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**Properties  
Which May Be  
Financed**

Treas. Reg. section 1.142(a)(5)-1(b)(1) describes the properties that may qualify as sewage disposal facilities under IRC section 142(a)(5) as those:

- used for the secondary treatment of wastewater that has a reasonably expected average daily raw wasteload concentration of biochemical oxygen demand (BOD) that exceeds 350 million per liter as oxygen. The oxygen is measured upon entry into the facility.
  - used for the preliminary and/or primary treatment of wastewater, to the extent used with secondary treatment. Pre-treatment is NOT included.
  - used for advanced or tertiary treatment of wastewater, in connection with and after, secondary treatment.
  - used for the collection, storage, use, processing and final disposal of wastewater and sewage sludge.
  - used for the treatment, collection, storage, use, processing, or final disposal of septage, AND
  - which are functionally related and subordinate to the properties described above.
- 

**Exception for  
BOD Limit**

If a facility treating wastewater exceeds the BOD limit, it will not fail to qualify to the extent that the failure is due to implementation of federal, state, or local water conservation program. (See **Treas. Reg. section 1.142(a)(5)-1(b)(2).**)

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## Sewage Disposal Facilities, Continued

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**Anti-Abuse Rule**

If there are any intentional manipulations of the BOD level to circumvent the BOD limit, the facility will not qualify. For example, increasing the volume of water in the wastewater before influent enters the facility with the intention of reducing the BOD limit.

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**Property Not Included as Sewage Facility**

If a property is not described in Treas. Reg. section 1.142(a)(5)(b)(1), it is not a sewage facility under IRC section 142(a)(5). For example, a property is not a sewage facility or functionally related and subordinate property, if such property is used for pre-treatment of wastewater, or related collection, storage, use, processing, or final disposal of the wastewater. In addition, property used to treat, process, or use wastewater subsequent to the wastewater's discharge into navigable water, is not a sewage facility.

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**Other Requirements**

The private activity bond rules stated in IRC sections 146, 147(a) through (g), and 150(b)(4) are applicable to bonds issued to finance sewage disposal facilities under IRC section 142(a)(5).

The arbitrage and rebate rules of IRC section 148 and the rules of IRC section 149 also apply to these bonds.

These rules are discussed in other modules of this text.

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## Section 8

### Solid Waste Disposal Facilities

#### General Rules

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**Definition** Treas. Reg. section 1.103-8(f)(2)(ii) provides that the term “solid waste disposal facilities” means any property or a portion thereof used for the collection, storage, treatment, utilization, processing, or final disposal of solid waste.

Only expenditures for that portion of property that is a solid waste disposal facility qualify as expenditures for a solid waste disposal facility.

The fact that a facility operates at a profit will not, of itself, disqualify the facility as a solid waste disposal facility.

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**Solid Waste** The term solid waste has the same meaning as section 203(4) of the solid Waste Disposal Act of 1965. Section 203(4) of the Solid Waste Disposal Act provides that solid waste means:

- garbage,
- refuse, AND
- other discarded solid materials, including solid waste material resulting from:
  - commercial activities,
  - industrial,
  - commercial, AND
  - agricultural operations.

Solid waste does not include solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as:

- silt,
- dissolved or suspended solids in industrial waste water effluents,
- dissolved materials in irrigation return flows, OR
- other common water pollutants.

Material will not qualify as solid waste unless, on the date of issuance of the bonds, the material is property that is useless, unused, unwanted or discarded solid material that has no market or other value at the place where it is located.

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*Continued on next page*

## Solid Waste Disposal Facilities, Continued

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### Solid Waste, continued

#### Example 1

Discarded corrugated containers purchased from a solid waste disposal company by a manufacturer of fiber products do not qualify as solid waste. The containers had a value where they were located and a corporation engaged in the business of manufacturing bleached paper board and other fiber products was willing to purchase the property at a stated price. (See **Rev. Rul. 75-184, 1975-1 CB 41.**)

#### Example 2

State law prohibits use of nonreturnable containers. A facility used by a beverage manufacturer to package beverages in such containers is not a solid waste disposal facility because the containers are not solid waste. (See **Rev. Rul. 80-197, 1980-2 CB 44.**) When the reusable container is returned, it is reintroduced into the distribution process and may be reused by the taxpayer. Even though there was no market for the returnable containers, the reusable containers do have a value to the taxpayer.

#### Example 3

A facility leased to a corporation that collects solid waste and sells salvageable metal to scrap dealers and combustibles to an adjacent public utility plant for fuel qualifies as a solid waste disposal facility. The corporation does not pay any amount for any material dumped at the collection stations. At this point, the garbage is useless and unwanted material. However, the equipment used to transport fuel product to the utility will not qualify as a solid waste disposal facility. (See **Rev. Rul. 76-222, 1976-1 CB 26.**)

#### Example 4

A minimal amount of water content is permitted in "solid waste." In PLR 9143036, the Service ruled that although the waste water effluent is 99.4 percent liquid, it qualifies as a solid waste when dewatered. The cost of the dewatering is a non-qualifying cost.

---

### Functionally Related and Subordinate Property

Property that is related and subordinate to the solid waste facility qualifies if it is of a character and size commensurate with the character and size of the facility. For example, office space must be located at or within the facility and directly related to the day-to-day operations of the facility.

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*Continued on next page*

## Solid Waste Disposal Facilities, Continued

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### Functionally Related and Subordinate Property

#### Example 1

In PLR 9002049, the Service ruled that specially designed trailers, road tractors and shuttle trucks, and the garage maintenance and truck washing facilities, and landfill tippers are functionally related and subordinate property. In this case, the city's disposal site was near capacity and the city was using a distant landfill to handle the garbage and hired a private entity to get it to the landfill.

#### Example 2

Odor control facilities installed by a corporation to a sanitary landfill are functionally related and subordinate property. (See **PLR 8526018**.)

---

### Production of Useful Material

A facility may have a solid waste disposal function and a function other than solid waste if material or heat that has utility or value is recovered or results from the disposal process.

The waste disposal function includes the processing pursuant to which such materials or heat is produced as a by-product. The waste disposal function does not include further processing that converts the material or heat into other products.

(See **Treas. Reg. section 17.1(a) (Temporary)**.)

---

### Allocation of Cost

The qualifying portion of the facility is determined by allocating cost of the facility between the solid waste disposal function and any other function. The method of allocation adopted by the issuer should, with reference to all the facts and circumstances with respect to the facility, be reasonable and reflect a separation of costs for each function of the property. (See **Treas. Reg. section 17.1(b) (Temporary)**.)

#### Example

A facility processes waste dumped by a municipality by separating metals, glass, and similar materials. As separated, some of the items are commercially salable. The metals and glass are sold after they are sorted, altered, and cleaned, and the glass is pulverized. The waste disposal function includes the processing of the metal and glass, but not any further processing.

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## Solid Waste Disposal Facilities, Continued

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### Allocation of Cost, continued

The remaining waste is burned at an incinerator. The gases generated are cleaned by the use of an electrostatic precipitator. The incinerator exhaust gases are cooled and reduced in volume by means of a heat exchange process using boilers. The precipitator is functionally related and subordinate to the waste disposal facility.

The heat is used to produce steam and sold to the operator of an adjacent electric generating facility and used by the operator to power its turbine generator. The pipes used to carry the steam from the facility to the adjacent electric generating facility are not within the solid waste disposal function of the facility.

**(See Example in Treas. Reg. section 17.1(c) (Temporary).)**

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### Other Requirements

The private activity bond rules stated in IRC sections 146, 147(a) through (g) and IRC section 150(b)(4) are applicable to bonds issued to finance solid waste disposal facilities under IRC section 142(a)(7).

The arbitrage and rebate rules of IRC section 148 and the rules of IRC section 149 are also applicable to these bonds.

These rules are discussed in other modules of this text.

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## Section 9

### Facilities for the Local Furnishing of Electrical Energy or Gas

#### General Rules

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**Definition** Treas. Reg. section 1.103-(8)(d)(2)(iii) provides that a facility for the local furnishing of electrical energy or gas is property that is:

- either property of a character subject to allowance for depreciation under IRC section 167 or land,
- used to produce, collect, generate, transmit, store, distribute, or convey electric energy or gas,
- used in a trade or business of furnishing electric energy or gas, AND a part of a system providing service to the general populace of one or more communities or municipalities. In no event should it provide services to more than two contiguous counties whether or not such counties are located in one state. **(See IRC section 142(f)(1).)**

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**Public Use** Treas. Reg. section 1.103-8(f)(1)(ii) provides that the facility is available for use by members of the general public if:

- the owner or operator of the facility is obligated (by a legislative enactment, local ordinance, regulation, or the equivalent) to furnish electric energy or gas to all persons that the facility will serve within its service area, AND
- it is reasonably expected that the facility will serve or be available to serve a large segment of the public in its service area.

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**Electric Energy Transmitted Outside Area** If a facility transmits electricity pursuant to an order of the Federal Energy Regulatory Commission (FERC), it will not be disqualified if:

- the portion of the cost of the facility financed with tax-exempt bonds is not greater than the portion of the cost of the facility allocable to the local furnishing of electric energy. **(See IRC section 142(f)(2)(A) and Treas. Reg. section 1.141-7T.)**

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*Continued on next page*

## Facilities for the Local Furnishing of Electrical Energy or Gas, Continued

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### **Special Rule**

IRC section 142(f)(2)(B) provides for a remedy where a facility financed with tax-exempt bonds fails to meet the requirements of IRC section 142(f) due to a subsequent order by FERC. In such an event, the bonds will not become taxable if:

- an escrow is established to defease the bonds within a reasonable period of time after the order becomes final, AND
  - bonds are redeemed no later than the first redemption date.
- 

### **Termination of Future Financing**

IRC section 142(f)(3) provides that no tax exempt bond may be issued for a facility described in IRC section 142(a)(8) after August 20, 1996 unless:

- (A) the facility will be used:
    - by a person who is engaged in the local furnishing of energy on January 1, 1997, and
    - to provide service within the area served by such person on January 1, 1997, OR
  - (B) the facility will be used by a successor in interest to such person for the same use and within the same area as described in (A) above.
- 

*Continued on next page*



## Facilities for the Local Furnishing of Electrical Energy or Gas, Continued

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### **Election to Terminate Tax- Exempt Bond Financing**

IRC section 142(f)(4) provides that, if a facility financed with tax-exempt bonds issued before August 20, 1996 ceases to qualify under IRC section 142(f) due to an expansion of the service area, the bonds will not become taxable if the furnisher makes an election and agrees that:

- the election is made with respect to all facilities for local furnishing of electricity and gas by such person,
- no tax-exempt bonds may be issued on or after August 20, 1996 with respect to such facilities of the furnisher,
- any expansion of the service area is not financed with tax-exempt bond proceeds described in IRC section 142(a)(8) and such expansion is not a nonqualifying use, AND
- all outstanding bonds used to finance the facility are redeemed not later than six months after the later of:
  - the earliest call date, OR
  - the date of the election.

**(See Treas. Reg. section 1.142(f)(4)-1T effective January 22, 1998.)**

IRC section 150(b)(4) will not apply to such facility if an election, as Described above, is made by the furnisher.

**(See Treas. Reg. section 1.150-5T which states that notices and elections filed on or after February 23, 1998 must be filed with the Chief, Employee Plans and Exempt Organizations of the appropriate key district office.)**

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## Facilities for the Local Furnishing of Electrical Energy or Gas, Continued

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### **Other Requirements**

The private activity bond rules stated in IRC sections 146, 147 (a) through (g), and 150(b)(4) are applicable to bonds issued to finance facilities for the local furnishing of electric energy and gas under IRC section 142(a)(8).

The arbitrage and rebate rules of IRC section 148 and the rules of IRC section 149 are also applicable to these bonds.

These rules are discussed in other modules of this text.

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## Section 10

### Local District Heating or Cooling Facility

#### General Rules

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**Definition** IRC section 142(g)(1) provides that the term “local district heating and cooling facility” means any property used as an integral part of a local heating or cooling system.

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**Local Heating and Cooling System** IRC section 142(g)(2) provides that a “local heating and cooling system” is any local system consisting of pipeline or network providing hot water, chilled water, or steam to two or more users for:

- residential, commercial, or industrial heating or cooling, OR
- processing steam.

The pipeline or network may be connected to a heating or cooling source.

A local system includes facilities furnishing heating and cooling to an area consisting of a city and one contiguous county.

---

**Other Requirements** The private activity bond rules stated in IRC sections 146, 147(a) through (g), and 150(b)(4) are applicable to bonds issued to finance local district heating or cooling facilities under IRC section 142(a)(9).

The arbitrage and rebate rules of IRC section 148 and the rules of IRC section 149 also apply to these bonds.

These rules are discussed in other modules of this text.

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## Section 11

### Qualified Hazardous Waste Disposal Facilities

#### General Rules

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**Definition** IRC section 142(h) provides that the term “qualified hazardous waste facility” means any facility for the disposal of hazardous waste by incineration or entombment but only if:

- the facility is subject to final permit requirements under subtitle C of Title II of the Solid Waste Disposal Act as in effect on October 22, 1986, AND
- financing is used only for the facilities (or a portion of the facility) which is used to dispose hazardous waste generated by the general public, rather than, the owner or operator of the facility, and person related to the owner or operator.

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**Hazardous Waste** HR Rep. No. 841, 99<sup>th</sup> Cong., 1<sup>st</sup> Sess., September 18, 1986, page II-707 provides that “hazardous waste” does not include radioactive waste.

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**Applicable Rules** The rules similar to rules for solid waste disposal facilities apply to qualified hazardous waste facilities, including:

- limiting the hazardous waste materials to materials having no market or other value at the place where the waste is located, AND
- the allocation of bond proceeds to qualifying portions of the facility.

**(See Section 8 of this Module, entitled “Solid Waste Disposal Facilities.”)**

A facility may qualify both as a solid waste disposal facility and a hazardous waste disposal facility. In this case, the waste processed at the facility consisted of at least 65 percent solid waste. **(See PLR 8924009.)**

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**Other Requirements** The private activity bond rules stated in IRC sections 146, 147(a) through (g), and 150(b)(4) are applicable to bonds issued to finance local district heating or cooling facilities under IRC section 142(a)(9). The arbitrage and rebate rules of IRC section 148 and the rules of IRC section 149 also apply to these bonds.

These rules are discussed in other modules of this text.

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## Section 12

# Environmental Enhancement of Hydroelectric Generating Facilities

## General Rules

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**Definition** IRC section 142(j) provides that the term “environmental enhancements of hydroelectric generating facilities” means:

- property the use of which is related to a federally licensed hydroelectric generating facility owned and operated by a governmental unit, AND
  - property which protects and promotes fisheries or other wildlife resources, including any fish bypass facility, fish hatchery, or fisheries enhancement facility, OR
  - property that is a recreational facility or other improvement required by the terms and conditions of any federal licensing permit for the operation of such generating facility.

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**Use of Proceeds** At least 80 percent of the net proceeds of the issue must be used to finance property that protects and promotes fisheries or other wildlife resources, including any fish bypass facility, fish hatchery, or fisheries enhancement facility.

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**Other Requirements** The private activity bond rules stated in IRC sections 147(a) through (g), and 150(b)(4) are applicable to bonds issued to finance environmental enhancements of hydroelectric generating facilities under IRC section 142(a)(12).

The arbitrage and rebate rules of IRC section 148 and the rules of IRC section 149 also apply to these bonds.

These bonds are NOT subject to the Volume Cap under IRC section 146(g)(3).

The rules are discussed in other modules of this text.

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## Section 13

### Auditing Techniques

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**Exempt facility bonds** IRC section 142 contains many different types of facilities, each of which has its own set of rules and requirements.

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**Auditing tips** The table below lists some tips for you when examining exempt facility bonds.

Step	Action
1	Review Form 8038 for designation of the subsection of IRC section 142 which applied on the issuance date.
2	Review the appropriate subsection and regulations for specific rules and requirements.
3	Request records from issuer/conduit borrower to support requirements of the appropriate subsection of IRC section 142.
4	Determine if the conduit borrower has complied with IRC section 142.
5	Verify that the bonds are in compliance with IRC sections 146, 147, 149, and 150.

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**Class exercise** In break-out groups, see if you can suggest the types of records that you would request for different types of exempt facilities.

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# Summary

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## Review of Module E

IRC section 142 provides that a bond will be considered to be an exempt facility bond if:

- 95 percent or more of the net proceeds of the bond are used to provide any one of the following facilities:
  - airports,
  - docks and wharves,
  - mass commuting facilities,
  - sewage facilities,
  - solid waste disposal facilities,
  - qualified residential rental projects,
  - facilities for the local furnishing of electric energy or gas,
  - local district heating or cooling facilities,
  - qualified hazardous waste facilities,
  - high-speed intercity rail facilities, OR
  - environmental enhancements of hydroelectric generating facilities.

IRC Section 142(b)(1) provides that certain exempt facility bonds must be governmentally owned. These are:

- airports,
- docks and wharves,
- mass commuting facilities, and
- environmental enhancements of hydroelectric generating facilities.

IRC Section 142(b)(2) provides general rules regarding offices that apply to ALL bonds described in IRC section 142(a).

Current regulations applicable to most exempt facility bonds are in Treas. Reg. section 1.103-8, however this section still contains the “substantially all” requirement, which pertains only to bonds issued prior to the TRA 1986.

Current regulations for applying the private business tests to output contracts are in Treas. Reg. sections 1.141-7T and -8T and generally apply to bonds issued on or after February 23, 1998.

The “public use” and the “functionally related and subordinate” rules contained in Treas. Reg. section 1.103-8(a)(2) and (3) are still applicable to bonds issued after 1986. Remember that these rules apply to ALL exempt facility bonds.

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## Summary, Continued

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### Review of Module E, continued

Treas. Reg. section 1.142(a)(5)-1 contains rules for sewage facilities, and apply to bonds issued after February 21, 1995.

Treas. Reg. sections 1.142(f)(4)-1T and 1.150-5T regarding the election to terminate tax-exempt bond financing of electric energy or gas facilities apply to elections made and notices filed on and after February 23, 1998.

Treas. Reg. section 17.1 contains temporary rules for allocation of costs relating to property used for both a solid waste disposal function and a function other than the disposal of solid waste. (See **TD 7362, 40 FR 26028, June 20, 1975.**)

In addition to meeting the general rules governing exempt facility bonds, they must also meet the specific requirements set forth for each particular type of bond.

Lastly, these bonds must also meet the applicable requirements of Code sections 146 through 150.

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### Preview of Module F

Module F continues the text's discussion of qualified private activity bonds. It covers bonds described in IRC section 143, which are:

- qualified mortgage bonds, AND
  - qualified veterans' mortgage bonds.
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END OF MODULE E

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