

Lesson 9

Section 150 – Definitions and Special Rules

Overview

Introduction

Section 150 contains definitions and various special rules. This module focuses primarily on the definitions contained in § 150(a). However, this Module will also set forth the special rules contained in § 150 and provide you with cross-references to enable you to find these topics elsewhere in the training materials.

Objectives

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

- Apply the definitions found in § 150(a) to various tax-exempt bond transactions
 - Identify the various subject matters contained in § 150
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Overview, Continued

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Section 1

Definitions Contained in § 150(a)

Introduction

Section 150(a) and the accompanying regulations contain certain definitions that are necessary for purposes of applying the provisions contained in §§ 103 and 141 through 150 and related regulations to tax-exempt bond financings.

Definitions in § 150(a)

Section 150(a) lists 5 basic definitions which are at the heart of many tax-exempt transactions. These are listed below and summarized for your convenience. In addition, § 150(a)(5) provides that property is treated as owned by a governmental unit if it is owned on behalf of that unit

Section	Defined Term	Definition Summary
150(a)(1)	Bond	Any obligation
150(a)(2)	Governmental unit	Does not include the US government or any agency or instrumentality of US.
150(a)(3)	Net Proceeds	The proceeds of a bond issue defined in Regulations § 1.148-1(b) minus a reasonably required reserve or replacement fund.
150(a)(4)	501(c)(3) organization	Any organization described in § 501(c)(3) and exempt from tax under § 501(a).
150(a)(6)	Tax-exempt bonds	Interest on such bonds is excluded from gross income.

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Definitions Contained in § 150(a), Continued

Significance of § 150(a)(2) Section 150(a)(2) provides that the term "governmental unit" does not include the United States or any agency or instrumentality thereof.

As you recall, § 103(a) states that generally gross income does not include interest on any "State or local bond". Section 103(c) defines "State or local bond" to mean an obligation of a State or political subdivision thereof. Regulations § 1.103-1(a) interprets that section and refers to States and political subdivisions collectively as state or local governmental units.

This definition is also important when distinguishing between a governmental and private activity bond, as discussed in Phase I Lesson 11 and Phase II Lesson 4. As a result of the definition in § 150(a)(2) use and ownership by the Federal government is treated as private business use.

Section 2

Definitions Contained in Regulations § 1.150-1

Overview

**Definitions in
Regulations
§ 1.150**

Regulations § 1.150-1 lists additional basic definitions which are at the heart of many tax-exempt transactions. Except as otherwise provided, the definitions in Regulations § 1.150-1 apply for all purposes of §§ 103 and 141 through 150 and are applicable to bonds issued after June 30, 1993, to which Regulations §§ 1.148-1 through 1.148-11 apply

General Definitions

What are Issuance Costs?

The issuer incurs certain costs in connection with issuing the bonds.

The costs include fees for individual services, such as:

- counsel to various parties,
- underwriter,
- financial advisor,
- trustee, and
- rating agencies

Costs also include direct out-of-pocket expenses, such as:

- printing fees for the offering document,
- engineering and feasibility studies, and
- guarantee fees other than qualified guarantees

Cost of issuance is defined in Regulations § 1.150-1(b).

Note: Section 147(g) provides restrictions on costs of issuance for certain types of bonds.

What is a Pooled Financing issue?

Regulations § 1.150-1(b) defines “pooled financing issue” to mean an issue the proceeds of which are to be used to finance purpose investments representing conduit loans to two or more conduit borrowers, unless those conduit loans are to be used to finance a single capital project.

Pooled financing bonds and the applicable requirements are covered in great detail in Phase III, Lesson 5.

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General Definitions, Continued

**What are
Governmental
Bonds?**

Regulations § 1.150-1(b) provides that “governmental bond” means any bond of an issue of tax-exempt bonds in which none of the bonds are private activity bonds. The same section of the Regulations defines a tax-exempt bond to mean any bond the interest on which is excludable from gross income under § 103(a).

The Code does not mention governmental bonds, but it does refer to private activity bonds. The private business tests and the private loan financing test of § 141 are used to distinguish between governmental and private activity bonds.

**What is
Working
Capital?**

Regulations § 1.150-1(b) defines the term working capital expenditures as any cost that is not a capital expenditure and further states that current operating expenses generally are working capital expenditures.

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General Definitions, Continued

Other Definitions Regulations § 1.150-1(b) includes other definitions, which are not discussed in detail here. Those terms are listed below:

Term	Definition
Bond	Any obligation of a State or political subdivision thereof under § 103(c)(1).
Bond Documents	Bond indenture or resolution, transcript of proceedings, and any related documents.
Conduit Borrower	The obligor on a purpose investment.
Conduit Financing	An issue the proceeds of which are used or are reasonably expected to be used to finance at least one purpose investment representing at least one conduit loan to one conduit borrower.
Conduit Loan	A purpose investment as defined in Regulations § 1.148-1.
Issue Date	<p>In reference to an issue—The first date on which the issuer receives the purchase price in exchange for delivery of the evidence of indebtedness representing any bond included in the issue.</p> <p>In reference to a bond—the date on which the issuer receives the purchase price in exchange for that bond.</p> <p>Note: in no event is the Issue Date earlier than the first day that interest begins to accrue on the bond or bonds for Federal income tax purposes.</p>
Obligation	Any valid evidence of indebtedness under general Federal income tax principles.
Private Activity Bond	A private activity bond as defined in § 141.
Qualified Mortgage Loan	A mortgage loan with respect to an owner-occupied residence acquired with the proceeds of an obligation described in §§ 143(a)(1) or 143(b).
Qualified Student Loan	A student loan acquired with the proceeds of an obligation described in § 144(b)(1).
Related Party	<p>In reference to a governmental unit or a 501(c)(3) organization—any member of the same controlled group.</p> <p>In reference to any other person—a related person as defined in § 144(a)(3).</p>
Taxable Bond	Any obligation the interest on which is not excludable from gross income under § 103.

Definition of Issue

What is an Issue?

Regulations § 1.150-1(c) provides that two or more bonds are generally part of the same issue if they are:

- sold at substantially the same time (within 15 days);
- sold pursuant to the same plan of financing; and
- reasonably expected to be paid from substantially the same source of funds.

Taxable and tax-exempt bonds are not part of the same issue.

Definition of Refunding

What is a Refunding?

Regulations § 1.150-1(d)(1) provides that a **refunding issue** means an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue (prior issue) including the following costs or similar costs if properly allocable to that refunding issue:

- issuance costs,
- accrued interest,
- capitalized interest on the refunding issue, or
- a reserve or replacement fund

Regulations § 1.150-1(d)(2) describes certain situations which are **NOT** refundings. These include:

- payments of certain interest,
- issues with certain different obligors,
- certain refundings of conduit financing issues, AND
- certain integrated transactions in connection with asset acquisitions

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Definition of Refunding, Continued

What is a Refunding? (continued)

Regulations § 1.150-1(d)(2)(ii)(A) provides 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 to the obligor of the other issue.

An obligor for this purpose means the actual issuer, except for the portion of an issue properly allocable to a purpose investment, when it means the conduit borrower.

Regulations § 1.150-1(d)(2)(i) provides that an issue is NOT a refunding issue if the only principal and interest that is paid with proceeds of the issue (without regard to the multipurpose issue rules of Regulations § 1.148-9(h) is interest on another issue that:

- Accrues on the other issue during a one-year period including the issue date of the issue that finances the interest;
- Is a capital expenditure, or
- Is a working capital expenditure to which the de minimis rule of Regulations § 1.148-6(d)(3)(ii)(a) applies.

Refunding bonds are covered in great detail in Phase III, Lesson 3.

Section 3

Change in Use Rules - § 150(b) and (c)

Overview

Generally, we use the phrase “change in use” to mean a change in the use of proceeds of an issue of State or local bonds from the use for which those proceeds were used, or expected to be used, as of the date of issue. Sections 150(b) and 150(c) contain special rules regarding situations where proceeds of certain qualified private activity bonds are used for a non-qualified use. These special rules generally deny the conduit borrower a deduction for the interest on the loan financed by the issue. Regulations § 1.150-4 provides remedial actions that may be taken to avoid these sanctions. Other regulations provide remedial actions that, if properly taken by issuers, will preserve tax-exemption of the bonds starting from the issuance date.

Content and Cross Reference

Sections 150(b) and 150(c) contain provisions applicable when proceeds of a tax-exempt bond issue are used for a non-qualified use. A full discussion of this topic, including the remedial actions, is in Phase II. Please see Lesson 10.

Section 4

Qualified Scholarship Funding Bonds - § 150(d)

**Qualified
Scholarship
Bonds**

A qualified scholarship funding bond is treated as a State or local bond. To issue qualified scholarship funding bonds, the issuing corporation must satisfy the following criteria:

- (1) The corporation must be a not-for-profit established exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965, AND
- (2) The corporation must be organized at the request of the State or one or more political subdivisions thereof and required by corporate charter and bylaws, or required by state law, to devote any income (after payment of expenses, debt service, and the creation of reserves) to purchase additional student loan notes or pay over any income to the United States.

See § 150(d).

**Content and
Cross
Reference**

Qualified scholarship funding bonds and the related qualifications are covered in depth in Phase II. Please see Lesson 9 for a full discussion of this topic.

Section 5

Qualified Volunteer Fire Department Bonds - § 150(e)

Qualified Volunteer Fire Department

A bond of a volunteer fire department is treated as a bond of a political subdivision of a state if the following criteria are met:

- (1) The department is a "qualified volunteer fire department" with respect to an area within the jurisdiction of the political subdivision.
- (2) Ninety-five percent or more of the net proceeds of the bond issue are used for the acquisition, construction, reconstruction, or improvement of a fire house (including land which is functionally related and subordinate thereto) or fire trucks to be used by such department.
- (3) The requirements of §§ 147(f) (public approval) and 149(d) (advance refunding) are met.

A "qualified volunteer fire department" with respect to a political subdivisions is any organization:

- organized and operated to provide emergency medical services for persons in an area (within the jurisdiction of the political subdivision) which generally is not provided with any other firefighting service, and
- which is required (by written agreement) by the political subdivision to furnish firefighting services in such area.

See § 150(e).

Content and Cross Reference

Section 150(e) outlines the requirements for a volunteer fire department to be "qualified" and its bonds to be treated as bonds of a political subdivision. Phase II covers this topic in more detail. Please see Lesson 15 for a full discussion of this topic.

Summary

Review of Lesson 9

Lesson 9 discussed the subject matter pertaining to § 150 with particular focus on the definitions contained in § 150(a) and Regulations § 1.150-1. Other subject matter contained in § 150 such as “change in use”, qualified scholarship funding bonds, and qualified volunteer fire department bonds also were discussed and a cross reference to other lessons in the training materials was provided.

Preview of Lesson 10

Lesson 10 begins the discussion of build America bonds.

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