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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

REG-136806-06

RIN 1545-BF87

Treatment of Payments in Lieu of Taxes under Section 141

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations modifying the standards for treating payments in lieu of taxes (PILOTs) as generally applicable taxes for purposes of the private security or payment test under section 141 of the Internal Revenue Code (Code). The proposed regulations provide State and local governmental issuers of tax-exempt bonds with guidance for applying the private security or payment test. The proposed regulations affect State and local governmental issuers of tax-exempt bonds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 16, 2007. Outlines of topics to be discussed at the

public hearing scheduled for February 13, 2007, at 10 a.m., must be received by January 16, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-136806-06), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered to CC:PA:LPD:PR (REG-136806-06), Courier's Desk, Internal Revenue Service, Crystal Mall 4 Building, 1901 S. Bell Street, Arlington, Virginia or sent electronically, via the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-136806-06). The public hearing will be held in the auditorium, Internal Revenue Service, New Carrollton Federal Building, 5000 Ellin Road, Lanham, Maryland 20706.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Vicky Tsilas or Carla Young, at (202) 622-3980; concerning submissions of comments, the hearing and/or to be placed on the building access list to attend the hearing, Kelly Banks, at (202) 622-0392 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1). Final regulations (TD 8712) under section 141 of the Code were published in

the **Federal Register** on January 16, 1997 (62 FR 2275) to provide comprehensive guidance on most aspects of the private activity bond restrictions. This document amends the Income Tax Regulations under section 141 of the Code by proposing modifications to the standards for treating payments in lieu of taxes as generally applicable taxes for purposes of the private security or payment test under section 141. These regulations are published as proposed regulations to provide an opportunity for public review and comment.

#### **Explanation of Provisions**

##### I. Introduction.

In general, interest on State and local governmental bonds is excludable from gross income under section 103 of the Code. Interest on a private activity bond, other than a qualified bond under section 141(e), is not excludable from gross income. Section 141(a) classifies a bond as a private activity bond if it is part of an issue that meets both the private business use test under section 141(b)(1) (the private business use test) and the private security or payment test under section 141(b)(2) (the private payment test). In addition, section 141(a) independently treats a bond as a private activity bond if it is part of an issue that meets the private loan test under section 141(c).

Section 141(b)(2) provides generally that an issue meets the private payment test if the payment of the debt service on more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (1) secured by any interest in property used or to be used for a private business use, or payments in respect of such property, or (2) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

## II. Private Payment Test in General.

Sections 1.141-4(c) and 1.141-4(d) of the Income Tax Regulations provide broad general rules for purposes of application of the private payment test. Private payments generally include any payments made, directly or indirectly, by any nongovernmental person that is a private business user of proceeds during a period of private business use and any payments made with respect to property financed with proceeds of an issue during a period of private business use, whether or not made by a private business user. In addition, private payments include property and payments in respect of property that are used or to be used for private business use to the extent that

any interest in that property or payments serves as security for the payment of debt service on an issue.

### III. Generally Applicable Taxes Exception.

Section 1.141-4(e) provides an exception to the otherwise-broad scope of payments taken into account under the private payment test in the case of "generally applicable taxes." In general, the purpose of the generally applicable taxes exception is to allow eligible tax payments made with respect to property or services to be used to pay debt service on an issue without causing private payments. For this purpose, §1.141-4(e)(2) defines a generally applicable tax to mean an enforced contribution exacted pursuant to legislative authority in the exercise of the taxing power that is imposed and collected for the purpose of raising revenue to be used for governmental purposes. To qualify as a generally applicable tax, a tax must have a uniform rate that is applied to all persons of the same classification in the appropriate jurisdiction and the tax must have a generally applicable manner of determination and collection. By contrast, under §1.141-4(e)(3), a payment does not qualify as a generally applicable tax if it is a special charge for a special privilege granted or service rendered (for example, a payment limited to property or persons benefited by an

improvement). Sections 1.141-4(e)(4)(ii) and (iii) set forth certain permissible and impermissible agreements that bear upon whether or not a tax has a generally applicable manner of determination and collection. For example, an agreement to reduce or limit the amount of taxes collected to further a bona fide governmental purpose is a permissible agreement.

#### IV. Certain Payments in Lieu of Taxes Treated as Generally Applicable Taxes.

In addition, existing §1.141-4(e)(5) treats certain tax equivalency payments or PILOTs as generally applicable taxes if (1) the payments are commensurate with and not greater than the amounts imposed by the statute for a tax of general application, and (2) the payments are designated for a public purpose and are not special charges (as described in §1.141-4(e)(3)). Existing §1.141-4(e)(5) further provides an example which states that a PILOT made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge.

The Treasury Department and the IRS are concerned that additional guidance may be needed regarding the existing standards for treating PILOTs as generally applicable taxes and that those existing standards potentially could be interpreted in an unduly broad manner to provide favorable

treatment for certain PILOTs which may have an insufficient link to generally applicable taxes. Conversely, the Treasury Department and the IRS are concerned that the last sentence of existing §1.141-4(e)(5)(ii), which provides as an example of a special charge a PILOT paid in consideration for the use of property financed with tax-exempt bonds, could be interpreted in an unduly restrictive manner to prevent any PILOTs with respect to property financed with tax-exempt bonds from being treated as generally applicable taxes.

To address these concerns, the Treasury Department and the IRS propose to modify the standards to better assure a reasonably close relationship between eligible PILOT payments and generally applicable taxes. The proposed clarification provides that an eligible PILOT payment must represent a fixed percentage of, or reflect a fixed adjustment to, the amount of generally applicable taxes in each year, based on comparable current valuation assessments. In addition, the Treasury Department and the IRS propose to eliminate the example in the last sentence of §1.141-4(e)(5)(ii). Regarding this latter proposal, the Treasury Department and the IRS believe that the existing definition of special charge under §1.141-4(e)(3) adequately addresses this principle.

The proposed standards for treating PILOTs as generally applicable taxes generally contemplate PILOTs based on property taxes. The Treasury Department and the IRS also seek public comment regarding whether any special rules are needed to address PILOTs based on other taxes, including sales taxes.

#### **Proposed Effective Date**

The proposed regulations are proposed to apply to bonds that are sold on or after February 16, 2007.

#### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this proposed regulation has been 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 (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 13, 2007, at 10 a.m. in the auditorium of the Internal Revenue Service, New Carrollton Federal Building, 5000 Ellin Road, Lanham, Maryland 20706. Due to building security procedures, visitors must enter at the New Carrollton Federal Building main entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the

hearing must submit written or electronic comments and an outline of the topics to be discussed and the amount of time to be devoted to each topic (signed original and eight (8) copies) by January 16, 2007. 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 authors of these regulations are Rebecca L. Harrigal, Vicky Tsilas, and Carla Young, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.141-4(e)(5) is revised to read as follows:

§1.141-4 Private Security or Payment Test.

\* \* \* \* \*

(e) \* \* \*

(5) Payments in lieu of taxes--(i) In general. A tax equivalency payment or other payment in lieu of a tax (PILOT) is treated as a generally applicable tax if--

(A) The payment is commensurate with and not greater than the amounts imposed by a statute for a generally applicable tax in each year; and

(B) The payment is designated for a public purpose and is not a special charge (as described in paragraph (e)(3) of this section).

(ii) Commensurate standard. For purposes of this paragraph (e)(5), a payment is "commensurate" with generally applicable taxes only if the amount of such payment represents a fixed percentage of, or reflects a fixed adjustment to, the amount of generally applicable taxes that otherwise would apply to the property in each year if the property were subject to tax. For example, a

payment is commensurate with generally applicable taxes if it is equal to the amount of generally applicable taxes in each year, less a fixed dollar amount or a fixed adjustment determined by reference to characteristics of the property, such as size or employment. A payment does not fail to be a fixed percentage or adjustment as a result of a single change in the level of the percentage or adjustment following completion of development of the subject property. The payment must be based on the current assessed value of the property for property tax purposes for each year in which the PILOTs are paid and that assessed value must be determined in the same manner and with the same frequency as property subject to generally applicable taxes. A payment is not commensurate if it is based in any way on debt service on an issue or is otherwise set at a fixed dollar amount that cannot vary with the assessed value of the property determined in the manner described in this paragraph (e)(5)(ii).

\* \* \* \* \*

Par. 3. Section 1.141-15 is amended by adding paragraph (m) to read as follows:

§1.141-15 Effective Dates.

\* \* \* \* \*

(m) Effective date for certain regulations relating to payments in lieu of tax. The rules of §1.141-4(e)(5) apply to bonds sold on or after [DATE THAT IS 120 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE **Federal Register**], that are subject to section 141.

Mark E. Matthews  
Deputy Commissioner for Services and Enforcement