This article is reprinted from Continuing Professional Education Exempt Organizations Technical Instruction Program for FY 2000 Training 4277-051, p. 147.

A. **POOLED FINANCINGS**

by
Clifford J. Gannett and Timothy L. Jones

1. Introduction

The proceeds of pooled financing bonds are loaned to two or more conduit borrowers. See section 149(f)(4) of the Internal Revenue Code. These borrowers may be governmental entities, 501(c)(3) organizations, or private business companies. Generally, pooled financing bonds are issued to reduce issuance costs and lower interest rates to the conduit borrowers. In exchange, borrowers of pooled bond proceeds give up some autonomy and often give up the opportunity to retain permissible arbitrage profits.

Special tax rules apply to pooled financing bonds. Some of these rules result from a concern that tax-exempt bonds not be issued substantially in advance of actual spending needs. Others reflect a belief that pooled bond issuers should not unduly benefit from their issuance of tax-exempt bonds on behalf of the ultimate consumers of the bond proceeds. Some rules simply result from the fact that there are two tiers of borrowers in pooled financing. This article discusses these different rules.

2. Non-arbitrage Limitations

A. In General

Pooled financing bonds must meet all the applicable requirements of section 141 through section 150 in order for bondholders to apply the exclusion of section 103(a) to income from pooled financing bonds. These requirements include the basic qualification rules such as the private activity bond rules of section 141 for governmental bonds and section 145 for qualified 501(c)(3) bonds. Also, requirements such as the 2% issuance costs limit continue to apply. See section 147(g)(1).

Specific non-arbitrage rules applicable to pool financing issues include section 149(f) (treatment of certain pooled financing bonds) and section 149(g) (treatment of hedge bonds). In the 1980s, billions of dollars of pooled bonds were issued in so-called "hedge pools". These pools provided protection against increases in interest rates or unfavorable changes in the tax laws. Issuance costs in these arrangements were often deferred until actual loans were made. As a result, pooled financing bonds were issued even though there was little or no expectation that the bonds' proceeds would be loaned.

Section 149(f) and 149(g) were enacted in 1988 and 1989, respectively, to limit the ability of issuers to issue tax-exempt bonds without appropriate expectations about the expenditure of the bonds' proceeds. These sections provide that the exclusion of interest from gross income under section 103(a) shall not apply to any "pooled financing bond" or "hedge bond" unless certain expectations requirements are met with respect to spending proceeds in a timely manner.

B. Section 149(f)

(1) Definition of a Pooled Financing Bond

Section 149(f)(4)(A) defines the term "pooled financing bond" as follows:

> The term "pooled financing bond" means any bond issued as part of an issue more than $5,000,000 of the proceeds of which are reasonably expected (at the time of the issuance of the bonds) to be used (or are intentionally used) directly or indirectly to make or finance loans to 2 or more ultimate borrowers.

Thus, bonds are not pooled financing bonds if the proceeds of the bonds' issue are $5,000,000 or less. Even if the proceeds of the issue are greater than $5,000,000, the bonds are not pooled financing bonds unless more than $5,000,000 of the proceeds of the issue are reasonably expected at the time of issuance to be be used (or are intentionally used) for loans to 2 or more conduit borrowers.

In addition, bonds are not pooled financing bonds if they are specifically excepted under section 149(f)(4)(B). Under section 149(f)(4)(B)(i), bonds generally are not pooled financing bonds if the private activity bond volume cap applies to the bonds' issue or would apply in the case of certain refunding bonds. Qualified veterans mortgage bonds are also excluded if the volume limitations of section 143(l)(3) apply to the bonds' issue.

Therefore, the rules of section 149(f) generally only apply to the four types of bonds that are not subject to the volume cap. Those bonds are as follows: 1) bonds that are not private activity bonds ("governmental bond"); 2) qualified 501(c)(3) bonds; 3) private activity bonds for governmentally owned airports, docks and wharves, and solid waste facilities; and (4) certain private activity bonds for high-speed intercity rail facilities.

Treas. Reg. section 1.150-1(b) defines the term "pooled financing issue." The regulation provides that an issue will be a pooled financing issue if the proceeds of the issue 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. Therefore, an issue may not fall within the definition of a pooled financing issue even though proceeds of the issue are used to finance conduit loans to multiple conduit borrowers if the proceeds are used to finance a single capital project.

The rules of Treas. Reg. section 1.150-1(c) under which two or more bonds may be treated as a single issue or as separate issues also apply to pooled financing bonds. Bonds may be treated as separate issues for purposes of section 149(f) if they finance separate purposes. See Treas. Reg. section 1.150-1(c)(3)(ii). Based on these rules, a pooled financing issuer may be able to avoid application of the requirements of section 149(f) to its bonds by treating each loan as a separate purpose investment financed by a separate issue. Each of these separate issues, however, would then have to independently meet the applicable qualification requirements.

(2) Issuer Expectations

Bondholders cannot exclude, under section 103(a), interest income from pooled financing bonds unless the bonds' issue meets the issuer expectation requirements of section 149(f)(2) and (3) with respect to expenditures for loans and issuance costs. These requirements were established to remove any incentives states or local governments might have to issue bonds when they did not expect to loan the proceeds.

Section 149(f)(2) requires an issuer of pooled financing bonds to reasonably expect that as of the close of the 3-year period beginning on the date of issuance of the issue that at least 95% of the net proceeds of the issue will have been used to make or finance loans to ultimate borrowers. Determining whether or not this requirement has been met requires:

i. The amount of proceeds that the issuer must reasonably expect to use to make or finance loans to ultimate borrowers must be identified. Typically, this amount is 95% of net proceeds of the issue. The term "net proceeds" is defined for this purpose to mean the proceeds of the issue less the following amounts: 1) proceeds used to finance issuance costs; 2) proceeds necessary to pay interest on the bonds during the 3-year period; and 3) amounts in reasonably required reserves. See section 149(f)(2)(C).

   If, however, only a portion of the net proceeds of an issue is reasonably expected (at the time of issuance of the bond) to be used (or is intentionally used) to make or finance loans, such portion and the other portion of such issue shall be treated as separate issues for purposes of determining whether the issuer expectations requirement is met. See section 149(f)(5)(B).

ii. The types of loans that the issuer expects to make or finance must be identified. For purposes of meeting the issuer expectations requirement, the term "loan" does not include nonpurpose investments (investment property, including tax-exempt bonds, acquired with gross proceeds of the issue but not to carry out the governmental purpose of the issue) or any use of proceeds by an agency of the issuer unless such agency is a political subdivision or instrumentality of the issuer. See section 149(f)(5)(A).

iii. The reasonableness of the issuer's expectations about the making or financing of loans from the pool must be evaluated. When evaluating the issuer's expectations, the issuer's expectations about interest rate changes or federal tax law changes can not be considered. See section 149(f)(2)(B).

Section 149(f)(3) sets forth two additional requirements that pool financing issues must meet with respect to payments of issuance costs. At least 95% of the reasonably expected legal and underwriting costs associated with the issuance of a pool financing issue must be paid not later than 180 days after the date of the issuance of the issue. Furthermore, the payment of legal and underwriting costs associated with the issuance of the issue cannot be contingent.

C. Section 149(g)

(1) Definition of Hedge Bonds

Section 149(g)(3)(A) states that, in general, the term "hedge bond" means any bond issued as part of an issue unless one of the following conditions are met:

i. The issuer of the bonds both (a) reasonably expects that 85% of the spendable proceeds of the issue will be used to carry out the governmental purposes of the issue within the 3-year period beginning on the date the bonds are issued, and (b) not more than 50% of the proceeds of the issue are invested in nonpurpose investments having a substantially guaranteed yield for 4 years or more.

ii. At least 95% of the net proceeds of the issue of which the bonds are a part are invested in tax-exempt bonds that are not subject to the alternative minimum tax (Non-AMT bonds). For purposes of this condition, amounts held for not more than 30 days pending reinvestment or bond redemption as well as amounts in a bona fide debt service fund are treated as invested in Non-AMT bonds.

iii. The bonds are refunding bonds of refunded bonds, which either were not hedge bonds or were hedge bonds that met the requirements for treatment as tax-exempt hedge bonds. Section 149(g)(3)(C) also contains rules that apply to bonds that refund bonds, which are not subject to the hedge bond rules.

(2) Issuer Expectations

Bondholders cannot exclude, under section 103(a), interest income from hedge bonds that otherwise would be tax-exempt pooled financing bonds unless the bonds' issue meets the issuer expectation requirements of section 149(g)(2) with respect to expenditures for loans and issuance costs. Section 149(g)(2) requires an issuer of a hedge bond to reasonably expect that the following percentages of spendable proceeds will be spent for the governmental purposes within the following periods beginning on the date the bonds are issued:

i. 10 percent within 1 year;

ii. 30 percent within 2 years;

iii. 60 percent within 3 years; and

iv. 85 percent within 5 years.

There is, however, a special exception in section 149(g)(4)(A) for bonds issued for a construction project having a construction period in excess of 5 years. Under the exception, the Service can rule that the reasonable expectation requirement of section 149(g)(2) is met for the bonds if it is reasonably expected that the portion of spendable proceeds of the bonds related to the project will be spent over a reasonable construction schedule.

In determining reasonable expectations with respect to both the general rule and the exception set forth above, an issuer may not take into consideration expectations about interest rate changes or federal tax law changes. See section 149(g)(4)(B) and 149(f)(2)(B). Pooled financing issuers normally will require certifications of the borrowers spending plans so that they will have the proper expectations.

D. Section 147

Section 147(b)(1) generally provides that private activity bonds shall not be qualified bonds if the average maturity of the bonds of the issue exceeds 120 percent of the average reasonably expected economic life of the facilities being financed. Section 147(b)(4) sets forth a special pooled financing rule whereby an issuer of qualified 501(c)(3) bonds can elect to have the 120% test applied against each loan as if each loan were a separate issue. In order to apply the special rule, the following conditions must exist:

i. 95 percent or more of the net proceeds of the issue of which such bond is a part are to be used to make or finance loans to 2 or more 501(c)(3) organizations or governmental units for acquisition of property to be used by such organizations.

ii. A demand survey was conducted before the issuance which shows a demand for financing greater than an amount equal to 120 percent of the lendable proceeds of the issue.

iii. 95 percent or more of the net proceeds of such issue are to be loaned to 501(c)(3) organizations or governmental units within 1 year of issuance.

iv. To the extent there are any unspent proceeds of the issue after such 1-year period, bonds issued as part of such issue are to be redeemed as soon as possible thereafter (and in no event later than 18 months after issuance).

v. The maturity date of any bond issued as part of such issue is not more than 30 years after the issue date. In the case of a refunding or series of refundings, the issue date, for this purpose, is the date on which the original bond was issued.

3. Arbitrage Limitations

A. In General

Pooled financing bonds are generally subject to the same general arbitrage rules that apply to any other tax-exempt bonds. There are, however, some special rules that apply to pooled financing bonds that have a substantial impact on the arbitrage obligations of pooled financing issuers. For instance, the issuer of pooled financing bonds cannot treat the proceeds of an issue as spent until they are spent by the conduit borrower of the proceeds. Other rules are discussed below.

B. Yield Restriction

Under section 148(a), bonds of an issue will generally be viewed as "arbitrage bonds" if the proceeds of the bonds are reasonably expected at the time of issuance to be used directly or indirectly to acquire higher yielding investments (purpose investments and nonpurpose investments) or replace funds which were used to acquire higher yielding investments. The bonds will also be treated as arbitrage bonds if the issuer intentionally uses any portion of the proceeds to acquire higher yielding investments. Interest from arbitrage bonds is not excludible from bondholders' gross income under section 103(a). See section 103(b)(2).

In evaluating whether a pooled financing issuer of bonds has violated the general section 148(a) yield restriction rule, the following general three step analysis should be applied:

i. Identify whether the loans financed by the proceeds of the pooled financing issue are treated as investments for purposes of the yield restriction rules.

ii. Identify whether investments allocated to the proceeds of the issue are excepted for one of the following reasons: 1) A temporary period under Treas. Reg. section 1.148-2(e) applies; 2) The investments are part of a reasonably required reserve or replacement fund described in Treas. Reg. section 1.148-2(f); or 3) The investments are part of a minor portion describe in Treas. Reg. section 1.148-2(g).

iii. Identify and apply the applicable definition of "materially higher" under Treas. Reg. section 1.148-2(d) to yield-restricted purpose and nonpurpose investments.

Conduit loans financed with proceeds of pooled financing bonds generally are purpose investments that are viewed as investment property for purposes of applying the yield restriction rule. See Treas. Reg. section 1.148-1(b) for a definition of the term "purpose investment" and section 148(b)(2). There is an exception from being treated as investment property, however, for Non-AMT tax-exempt bonds. See section 148(b)(3). Gross proceeds of pooled financing bonds allocated to these purpose investments continue to be allocated to the purpose investment and subject to the yield restriction rules applicable to purpose investments until the sale, discharge, or other disposition of the investment. See Treas. Reg. section 1.148-6(d)(2)(i).

Proceeds allocable to nonpurpose investments must also meet the yield restriction rules whether or not the proceeds and allocable investments are held by the pooled financing issuer or the conduit borrower. If the proceeds are held by the pooled financing issuer, section 148(c)(2) and Treas. Reg. section 1.148-2(e)(4) set forth a limited temporary period exception from the requirement that the nonpurpose investments be yield-restricted.

C. Calculating Yield

When determining the yield on a pooled financing issue and the yield on investments for purposes of the arbitrage yield restriction and rebate rules under section 148, Treas. Reg. section 1.148-9(h)(1)(i) provides that generally all of the bonds of the issue will be treated as a single issue despite the fact that the pooled financing issue is a multipurpose issue. There is an exception, however, in instances where the proceeds of an issue are allocable to two or more conduit loans that are tax-exempt bonds. In those cases, the portion of pooled financing bonds allocable to the separate purposes of those tax-exempt bonds are treated as separate issues for purposes of determining yield on the issue and yield on allocable investments. The rules for allocating bonds for this purpose are set forth in Treas. Reg. section 1.148-9(h)(4).

D. Yield Restriction Exceptions

(1) The 3-Month Temporary Period

A limited temporary period exception applies to proceeds from the sale or repayment of any loans held by the pooled financing issuer which are reasonably expected to be used to make or finance new loans. That temporary period is three months. See section 148(c)(2)(B) and Treas. Reg. section 1.148-2(e)(4)(ii).

(2) The 6-Month Temporary Period

Section 148(c)(2)(A) generally permits the unrestricted investing of proceeds of a pooled financing issue by a pooled financing issuer in nonpurpose investments during an initial 6-month temporary period before the proceeds are loaned to a conduit borrower if the issue is a new money pooled financing issue.

(3) The 2-Year Temporary Period

Section 148(c)(2)(C)(ii) permits unrestricted investing during an initial 2-year temporary period for pooled financing bonds the proceeds of which are used to finance loans for construction expenditures under section 148(f)(4)(C)(iv). The language of this provision also implies that a pooled financing issue could be bifurcated for purposes of applying the 6-month temporary period to the non-construction portion of the issue and the 2-year temporary period to the construction portion.

(4) The 3-Year Temporary Period

If a loan (purpose investment) has been made of proceeds of pooled financing bonds to a conduit borrower, the general temporary period exceptions (the 3-year temporary period for capital projects and the 13 month temporary period for restricted working capital expenditures) will typically apply while the proceeds and allocable investments are held by the conduit borrower. The requirements of the 3-year temporary period rule such as the expenditure test, the time test, and the due diligence test, should, however, be applied separately to each conduit loan financed by the pooled financing bonds. See Treas. Reg. section 1.148-2(e)(2)(i). Furthermore, any available temporary period for proceeds held by a conduit borrower must be reduced by the period of time during which those proceeds were held by the issuer before being loaned. See Treas. Reg. section 1.148-2(e)(4)(i).

Example

Proceeds of a pooled financing issue are held by the issuer in nonpurpose investments for 5 months before being loaned to a conduit borrower. The 6-month temporary period exception applies to the nonpurpose investments held by the pooled issuer. The proceeds also qualify for an additional 31-month temporary period after being loaned to the conduit borrower if the requirements of the 3-year temporary rule are otherwise met.

(5) Other Exceptions to Yield Restriction

Proceeds of a pooled financing issue may also be permitted to be invested in unrestricted investments if the proceeds are a minor portion of the proceeds as defined in section 148(e) or allocable to a reasonably required reserve fund under section 148(d). Treas. Reg. section 1.148-9(h)(1)(ii) and (iii) provides that a multipurpose issue will be treated as a single issue for purposes of apply the provisions of section 148(d) and section 148(e).

E. Materially Higher

Finally, after identifying allocable investments and applying the above exceptions, it must be determined whether the yield on any investments was materially higher than the yield permitted on that class of investments. See Treas. Reg. section 1.148-2(d)(2). For most purpose and nonpurpose investments of pooled financing bonds, the definition of materially higher will be one-eighth of 1 percentage point. For program investments (as defined in Treas. Reg. section 1.148-1(b)) and qualified student loans, materially higher means 1 and one-half percentage points and 2 percentage points, respectively.

4. Rebate Rules

A. Allocations

Section 148(f) generally provides that, subject to certain exceptions, a bond will be an arbitrage bond and not tax-exempt unless investment earnings on allocable nonpurpose investments in excess of bond yield are rebated to the United States. Nonpurpose investments allocable to pooled bond proceeds held by the pooled financing issuer or the conduit borrower are subject to the rebate rules. Gross proceeds of a pooled financing issue invested in a purpose investment are generally deallocated from the issue for purposes of the rebate rules on the date on which the conduit borrower allocates the gross proceeds of the purpose investment to a proper expenditure. See Treas. Reg. section 1.148-6(d)(2)(i). Treas. Reg. section 1.148-6(d)(2)(ii) provides, however, if the gross proceeds of the issue are allocated to a purpose investment that is a qualified mortgage loans and qualified student loans, those gross proceeds are allocated to an expenditure for the governmental purpose of the issue on the date on which the issuer allocates gross proceeds to that purpose investment.

B. Investment Blending

For purposes of determining the rebatable amount, the nonpurpose investments of the proceeds of the entire pooled financing issue are blended unless all of the conduit loans are also tax-exempt bonds. See Treas. Reg. section 1.148-9(h). Thus, unless there is an exception, all earnings above the bond yield at the issuer level or at the conduit borrower level on nonpurpose investments must be returned to the federal government.

C. Rebate Exceptions

(1) Generally

The exceptions to rebate that might apply include three spending exceptions and a small issuer exception. The three spending exceptions include two statutory exceptions (a general 6-month spending exception for non-construction financings under section 148(f)(4)(B) and a two-year spending exception for construction financings under section 148(f)(4)(C)) and a regulation exception (a 18-month spending exception under Treas. Reg. section 1.148-7(d)).

(2) Elections

The spending exception rules can be applied by pooled financing issuers in a variety of ways. The spending exceptions generally apply to a pooled financing issue as a whole, rather than to each loan separately. See Treas. Reg. section 1.148-7(b)(6)(i). Treas. Reg. section 1.148-7(b)(6)(ii) provides, however, that a pooled bond issuer may, on or before the issue date, elect to apply the spending exceptions separately for each conduit loan. Elections must be in writing and should be kept with the bond documents. See Treas. Reg. section 1.148-1(d).

If the issuer elects to treat each loan separately, the rebate requirements apply to, and none of the spending exceptions are available for, gross proceeds of the pooled financing bonds before the date on which the spending requirements for those proceeds begins. See Treas. Reg. section 1.148-7(b)(6)(ii). The applicable spending requirements for a loan begin on the earlier of the date the loan is made, or the first day following the 1-year period beginning on the issue date of the pooled financing issue.

Even when the issuer makes this election, the pooled financing issue will be an issue of arbitrage bonds unless the rebate requirements are met with respect to the proceeds of the entire issue including proceeds held by the pooled financing issuer and each of the conduit borrowers. Treas. Reg. section 1.148-7(b)(6)(ii)(B). The pooled financing issuer remains solely responsible for rebating arbitrage to the federal government. Despite application of the exceptions, rebatable arbitrage may be generated by nonpurpose investments allocable to proceeds in the reserve funds of the pooled bond issue.

The time when this exception begins depends on whether an election has been made to apply the spending exception to each loan. If the election is not made, then the period begins when the bonds are issued. If the election is made, then the period begins on the loan date or on the first day following the one-year period beginning on the date the bonds are issued, which ever is earlier. Under those circumstances, the bond proceeds are subject to the rebate requirements prior to the date that the spending requirements begin.

(3) ~~The 6-month Spending Exception~~

The time when this exception begins depends on whether an election has been made to apply the spending exception to each loan. If the election is not made, then the period begins when the bonds are issued. If the election is made, then the period begins on the loan date or on the first day following the one-year period beginning on the date the bonds are issued, whichever is earlier. Under those circumstances, the bond proceeds are subject to the rebate requirements prior to the date that the spending requirements begin.

(4) ~~The 2-year Spending Exception~~

This exception can apply to the entire pooled financing issue only if the issuer reasonably expects, as of the date of issue, that 75% of the available construction proceeds of the issue will be allocated to construction expenditures for property owned by a section 501(c)(3) organization or a governmental entity. For this purpose, construction expenditures are capital expenditures (as defined Treas. Reg. section 1.150-1(b)) that are allocable to the cost of real property (as defined in Treas. Reg. section 1.148-7(e)(3)(i) or constructed personal property (as defined in Treas. Reg. section 1.148-7(g)(3). Construction expenditures do not include expenditures for acquisitions of interests of land or other existing real property.

If the pooled financing issuer elects to apply the spending exceptions to each conduit loan separately, the 2-year exception can be applied to any loan for which the issuer expects that 75% of the available construction proceeds of that loan will be allocated to construction expenditures. The 2-year period begins on the earlier of the date on which the loans are made or on the first day following the one-year period beginning on the date the bonds are issued.

A pooled financing issuer can pay rebate on one conduit loan and elect to pay penalty in lieu of rebate in accordance with section 148(f)(4)(C)(vii) on another conduit loan. Such elections, which are ordinarily made before the issue date, may be made by the pooled financing issuer on or before the date the loan is made.

If an issuer elects to bifurcate an issue into a construction issue and a non-construction issue under Treas. Reg. section 1.148-7(j), the issuer may still elect to apply the spending exceptions separately to each loan. In addition, if any part of a loan is to be used for construction expenditures, the issuer can bifurcate the loan into a construction and non-construction issue.

(5) The 18-month Spending Exception

Similar to the other spending exceptions, the time when this exception begins is the date the bonds are issued unless the issuer has elected to apply the spending exceptions separately to each loan. Treas. Reg. section 1.148-7(d)(4) generally provides that the 18-month exception is inapplicable to an issue any portion of which is treated as meeting the rebate requirement under the 2-year exception. The example in Treas. Reg. section 1.148-7(b)(6)(ii)(D) indicates that this limitation applies only if the issue or loan is bifurcated into separate construction and non-construction issues. If the election is made to apply the spending exceptions separately, the example makes it clear that the 18-month exception is applicable to a loan even if the 2-year exception is elected for another loan.

Example

On January 1, 1994, Authority J issues bonds. As of the issue date, J reasonably expects to use the proceeds of the issue to make loans to City K, County L, and City M. J does not reasonably expect to use more than 75 percent of the available construction proceeds of the issue for construction expenditures. On or before the issue date, J elects to apply the spending exceptions separately for each loan. On February 1, 1994, J loans a portion of the proceeds to K, and K reasonably expects that 45 percent of those amounts will be used for construction expenditures. On the date this loan is made, J elects to treat 60 percent of the amount loaned to K as a separate construction issue, and also elects the penalty in lieu of rebate for the construction issue. On March 1, 1994, J loans a portion of the proceeds to L and L reasonably expects that more than 75 percent of those amounts will be used for construction expenditures. On March 1, 1995, J loans the remainder of the proceeds to M, and none of those amounts will be used for construction expenditures.

No spending exception is available to J with respect to earnings of nonpurpose investments allocable to the issue's gross proceeds before the amounts are loaned to K, L, and M. On those earnings, the applicable rebate requirements must be met.

For the periods beginning on the dates the loan are made, the issuer's rebate obligations with respect to proceeds allocable to each loan are as follows:

i. *For proceeds allocable to the loan to K, the spending periods begin on February 1, 1994. With respect to the amount loaned to K that is treated as a separate construction issue, the penalty in lieu of rebate must be paid for any failure to meet a spending requirement for that portion.*

   With respect to the non-construction portion of the loan, rebate must be paid unless the 6-month exception applies. The 18-month exception is not applicable since a portion of the loan is treated as a construction issue.

ii. *For proceeds allocable to the loan to L, the spending periods begin on March 1, 1994 and rebate must be paid unless the 6-month, 18-month, or the 2-year exception applies.*

iii. *For the proceeds allocable to the loan to M, the spending periods begin on January 2, 1995 (instead of March 1, 1995) because January 2, 1995 is the date that is the earlier of the date the loan is made or the first day following the 1-year period beginning on the issue date. See Treas. Reg. section 1.148-7(b)(6)(ii). The rebate requirement must be satisfied for those amounts unless the 6-month or 18-month exception is satisfied.*

(6) Small Issuer Exception

An issue will not be subject to rebate if the issue qualifies for the small issuer exception pursuant to section 148(f)(4)(D). In general, an issue 95% or more of the net proceeds of which are to be used for local governmental activities of the issuer qualifies for the small issuer exception if the issuer reasonably expects, as of the issue date, that the aggregate face amount of all tax-exempt bonds (other than private activity bonds) issued by it during the calendar year will not exceed $5,000,000. The small issuer exception generally applies only to bonds issue by governmental units with general taxing powers. See Treas. Reg. section 1.148-8.

In determining the $5,000,000 size limitation of a pooled financing issuer, bonds of a pooled financing issue are not counted for purposes of applying the small issuer exception to an issuer's other issues to the extent that the pooled financing issuer is not an ultimate borrower in the financing and the conduit borrowers are governmental units with general taxing powers and not subordinate to the issuer. See section 148(f)(4)(D)(ii)(II) and Treas. Reg. section 1.148-8(d)(1).

Under Treas. Reg. section 1.148-8(b), the portion of pooled financing bonds allocable to a loan to a conduit borrower qualifies for the small issuer exception, regardless of the size of either the pooled financing or of any loan to other conduit borrowers, if the following three conditions are met:

i. The bonds of the pooled financing are not private activity bonds;

ii. None of the loans to conduit borrowers are private activity bonds; and

iii. The loan to the conduit borrower meets all the requirements of the small issuer exception.

In this example, the small issuer exception would not apply to the portion of pooled financing bonds allocable to either (i) loans that do not meet the above three conditions or (ii) any unloaned proceeds.

5. Refundings

Treas. Reg. section 1.150-1(d)(1) provides generally that a refunding issue is an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue (the "refunded issue") including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue. Treas. Reg. section 1.150-1(d)(2)(ii) further 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 with respect to the obligor of the other issue. The term "obligor" means the actual issuer of the issue or the conduit borrower of a portion of an issue properly allocable to an investment in a purpose investment (except for loans for qualified mortgages, qualified student loans, or similar program investments). Therefore, a loan from a pooled financing issue could cause a conduit borrower to be viewed as an obligor in an instance where the borrower would not otherwise be viewed as an obligor.

There are special refunding rules for conduit financing issues set forth in Treas. Reg. section 1.150-1(d)(2)(iii) that apply to pooled financing issues. Treas. Reg. section 1.150-1(b) provides that the term "conduit financing issue" means 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. Therefore, conduit financing issues for purposes of the special refunding rules include issues that finance a single purpose investment as well as pooled financing issues that finance multiple purpose investments.

Treas. Reg. section 1.150-1(d)(2)(iii)(A) provides the general refunding rule with respect to conduit financing issues that the use of proceeds of a conduit refunding issue by the conduit financing issuer determines whether the conduit refunding issue is a refunding of the conduit financing issue (in addition to a refunding of the obligation that is the purpose investment). The conduit refunding issue would not be a refunding of a conduit financing issue if the conduit financing issuer reasonably expects as of the date of receipt of the proceeds of the conduit refunding issue to use those amounts within 6 months to acquire a new purpose investment. Any new purpose investment is treated as made from the proceeds of the conduit financing issue. For purposes of this rule, Non-AMT tax-exempt bonds are treated as purpose investments.

6. Conclusion

Congress has enacted tax laws specifically applicable to pooled financings in an effort to address both the complexities of such financings and potential areas of abuse. Application of these requirements should deter issuers from issuing such financing for reasons other than to make loans in a timely manner to two or more proper, ultimate users.