



Toll Bridges =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6

Year 7 =

X =

m =

Dear

This is in response to the ruling request submitted on behalf of the Issuer that (a) the Proposed Bonds (as defined below) are not refunding bonds under § 149(d) of the Internal Revenue Code (the “Code”) and § 1.150-1(d) of the Income Tax Regulations, and (b) the proceeds of the Proposed Bonds (as described below) will be expended for a governmental purpose at the time the proceeds of the Proposed Bonds are transferred to the Bank in order to redeem or defease the Prior Bonds for purposes of § 1.148-6(d).

**FACTS AND REPRESENTATIONS**

The Issuer was created by State law in Year 3. Once the Prior Bonds are redeemed or defeased, the Issuer is responsible for the administration of all toll revenues from the Toll Bridges, including the Special Toll (described below) and maintains an account and sub-accounts to document the toll revenue. The Issuer is governed by a board (the “Board”) comprised of X members. The voting members of the Board are appointed by the Local Authorities and Regional Authorities, which are either political subdivisions with substantial police, taxing, and eminent domain powers, or instrumentalities of the political subdivisions. Generally, members of the Board are appointed for the shorter of four years or their term of office with the appointing authority. State law makes no

provision for the removal of the board members, other than by loss of office with the appointing authority. The Issuer has a wide variety of powers, including the power to make or enter into contracts, employ agents or employees, acquire, construct, manage, maintain, lease, or operate any public facility or improvement within its jurisdiction, sue and be sued in its own name, and issue bonds and otherwise incur debts, liabilities, or obligations. However, the Issuer has no taxing, eminent domain or police power.

The Board adopts an annual operating budget for the Issuer and a capital budget for Toll Bridge improvements and other transportation improvements, including those for the Program (described below). In connection with its capital budget, the Board adopts and reviews long-range plans for the Toll Bridges giving priority to recommendations of the Department. The Issuer funds its operating and capital budgets from the toll revenues, including the Special Toll, collected from the Toll Bridges. Although Issuer must give priority to the Department's recommendations, it has sole control of its expenditures.

The Bank is a State conduit financing agency established by State law that is headed by an executive director, who is appointed by the Governor of the State. The Bank is governed by a board of directors one of which is appointed by the Governor, another of which is an elected State official, and three of which are each heads of State agencies. The Bank may issue bonds to pay the cost of any project or otherwise to support the economic development of the State.

The Department is a State agency the head of which is appointed by the Governor, subject to the confirmation by the Senate of the State. The Department's powers and duties include comprehensive transportation planning, developing resources to meet State transportation needs, and planning, designing, constructing, operating, and maintaining transportation systems within State which are designated by the legislature as the responsibility of the Department.

Following a natural disaster in the Region in Year 2, the Department commenced a program (herein referred to as the "Program") to rehabilitate, retrofit, improve, or replace the Toll Bridges, all of which are State-owned. In Year 3, the State enacted legislation authorizing the imposition of a special toll for the use of the Toll Bridges in the amount of \$m (the "Special Toll"), to be used exclusively by the Department for the Program. In Year 4, the State enacted legislation authorizing the Bank to issue bonds the proceeds of which were to be used to provide additional financing for the Program. In Year 5 and Year 6, the Bank issued the Prior Bonds and loaned the proceeds thereof to the Department for the Program. The Prior Bonds are exclusively paid from, and secured by, the Special Toll.

In Year 6, the State enacted legislation (the "New Legislation") which addressed an evident Program funding shortfall. The New Legislation designates additional funds from various sources to fund this shortfall; it authorizes the Issuer to issue bonds (the

“Proposed Bonds”) and transfer the proceeds thereof to the State for the purpose of defeasing or paying the Prior Bonds. The New Legislation also provides for the transfer of the Special Toll to the Issuer upon defeasance or payment of the Prior Bonds and permits the Special Toll, together with other toll revenues, to be used by Issuer to secure and pay the Proposed Bonds. The Issuer may retain and expend the Special Toll, after a certain amount of Special Toll revenues are collected, for non-Program related Regional transportation improvements. The Issuer may also increase (effective no earlier than Year 7) the amount of the Special Toll for the purpose of completing the Program and meeting its obligations under the New Legislation, including paying the debt service on the Proposed Bonds.

Under the New Legislation, the Department develops contract specifications and bid documents, awards contracts, and is authorized to provide incentives and disincentives to maximize the number of bidders, and to encourage the timely and thorough completion of the contracts. However, all contract specifications and bid documents related to the Toll Bridges must be reviewed and approved by the Issuer before their release. Except for certain other designated funding sources, the Issuer pays for all toll-funded Toll Bridge construction or improvement projects, whether part of the Program or outside of the Program. The Department continues to be responsible for the installation of Toll Bridge improvements, including those within the Program, in accordance with the capital budget adopted by the Issuer.

## LAW AND ANALYSIS

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on a state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to (i) any arbitrage bond within the meaning of § 148; and (ii) any bond unless such bond meets the applicable requirements of § 149.

Section 148(a) provides that, for purposes of § 103, the term “arbitrage bond” means any bond issued as part of an issue any portion of the proceeds of which are reasonable expected (at the time of issuance of the bond) to be used directly or indirectly (1) to acquire higher yielding investments, or (2) to replace funds which were used directly or indirectly to acquire higher yielding investments. For purposes of § 148(a), a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in § 148(a)(1) or (2).

Section 148(b)(1) provides that for purposes of § 148 the term “higher yielding investments” means any investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue.

Section 149(d)(1) provides, in part, that nothing in § 103(a) or in any other provision of the law shall be construed to provide an exemption from Federal income tax for interest

on any bond issued as part of an issue described in § 149(d)(3) or (4). Section 149(d)(3) provides, in part, that an issue is described in § 149(d)(3) if any bond (issued as part of an issue), hereinafter referred to as the “refunding bond,” is issued to advance refund a bond unless (a) the refunding bond is only the 1st advance refunding of the original bond if the original bond is issued after 1985, or (b) in the case of refunded bond issued after 1985, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed.

Section 149(d)(5) provides that, for purposes of §§ 141 through 150, a bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond. Section 149(d)(4) provides that an issue is described in § 149(d)(4) if any bond (issued as part of such issue) is issued to advance refund another bond and a device is employed in connection with the issuance of such issue to obtain a material financial advantage (based on arbitrage) apart from savings attributable to lower interest rates.

Section 1.148-6(d)(ii) provides that an allocation of gross proceeds of an issue to an expenditure must involve a current outlay of cash for a governmental purpose of the issue. A current outlay of cash means an outlay reasonably expected to occur not later than 5 banking days after the date as of which the allocation of gross proceeds to the expenditure is made. Section 1.148-6(d)(7) provides that any payment of gross proceeds of the issue to a related party of the payor is not an expenditure of those gross proceeds.

Section 1.150-1(d)(1) provides that refunding issue means an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue (a prior 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. Section 1.150-1(d)(2)(A) provides that in general an issue is not a refunding issue to the extent that the obligor (as defined in § 1.150-1(d)(2)(ii)(B)) of one issue is neither the obligor of the other issue nor a related party with respect to the obligor of the other issue.

Section 1.150-1(b) provides that “related party” means, in reference to a governmental unit or a 501(c)(3) organization, any member of the same controlled group. Section 1.150-1(e) provides that “controlled group” means a group of entities controlled directly or indirectly by the same entity or group of entities within the meaning of § 1.150-1(e). Section 1.150-1(e)(1) provides that the determination of direct control is made on the basis of all the relevant facts and circumstances. One entity or group of entities (the controlling entity) generally controls another entity or group of entities (the controlled entity) for purposes of § 1.150-1(e) if the controlling entity possesses either of the following rights or powers and the right or powers are discretionary and non-ministerial: (i) the right or power both to approve and to remove without cause a controlling portion of the governing body of the controlled entity, or (ii) the right or power to require the use

of funds or assets of the controlled entity for any purpose of the controlling entity. Section 1.150-1(e)(3) provides that an entity is not a controlled entity under § 1.150-1(e) if the entity possesses substantial taxing, eminent domain, and police powers. For example, a city possessing substantial amount of each of these sovereign powers is not a controlled entity of the state.

Under the general rule of § 1.150-1(d)(1), because the proceeds of the Proposed Bonds will be used to defease or pay the principal, interest, or redemption premium of the Prior Bonds, the Proposed Bonds will be refunding bonds of the Prior Bonds unless the exception of § 1.150-1(d)(2)(ii) relating to different obligors applies.

We conclude that the Prior Bonds and the Proposed Bonds will have different obligors. The Prior Bonds were issued by an agency of the State. The Proposed Bonds will be issued by the Issuer the Board of which is controlled by political subdivisions with substantial police, taxing, and eminent domain powers or by instrumentalities of the political subdivisions. Issuer's Board members may not be removed by the State. The Issuer has no control over the State or its agencies, the Bank or the Department. The Issuer sets and approves its own operating budget and establishes a capital budget for the Toll Bridges taking into account recommendations of the Department. The Issuer has final approval authority over contract specifications and bid documents for Toll Bridge improvements and Department must design and construct the Toll Bridge projects in accordance with the Issuer's capital budget. After the Prior Bonds are redeemed or defeased, the Issuer has sole control over the toll revenue from the Toll Bridges, including the Special Toll and, after completion of the Program, may use the Special Toll for non-Program related improvements to the Toll Bridges. Within legislatively imposed limits, the Issuer has the authority to increase or decrease the Special Toll to complete the Program and to pay the debt service on its bonds, including the Proposed Bonds. Finally, unlike the Prior Bonds for which debt service is paid solely from the Special Toll, the Proposed Bonds are to be paid from, and secured by, all toll revenues under the jurisdiction of the Issuer.

We now direct our analysis to the issue of whether the proceeds of the Proposed Bonds will be expended for a governmental purpose upon their transfer to the State. Because we have concluded that the Issuer and the State are not related parties, the transfer of the proceeds of the Proposed Bonds to the State or any agency of the State to be used to redeem or defease the Prior Bonds will be treated as a current outlay of cash for a governmental purpose and will be an expenditure for purposes of § 1.148-6(d) at the time of the transfer to the State or any agency of the State.

Accordingly, we conclude that the Proposed Bonds are not refunding bonds with respect to the Prior Bonds under §§ 149(d) and 1.150-1(d). In addition, we conclude that the transfer of the proceeds of the Proposed Bonds to the Department to be used to defease or pay the Prior Bonds will be an expenditure for purposes of § 1.148-6(d).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including, without limitation, whether the interest on the Proposed Bonds will be excludable from gross income under § 103.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,  
Assistant Chief Counsel  
(Exempt Organizations/Employment  
Tax/Government Entities)

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