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Legend

Authority =

Bonds =

Borrower =

Consent
Decree =

Plant =

Purchaser =

State =

Unit A =
Unit B =
Month 1 =
Month 2 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
Year 6 =
Year 7 =

Dear :

This letter is in response to your request for rulings that the demolition of the Project Facilities (defined below) (1) will not cause the interest on the Bonds to fail to be excludable from gross income under § 103 of the Internal Revenue Code of 1954 (“the 1954 Code”) and (2) will not cause § 150(b) of the Internal Revenue Code of 1986 (“the 1986 Code”) to apply, precluding Borrower from deducting interest on the financing agreements relating to the Bonds.

FACTS AND REPRESENTATIONS

The Authority is a body corporate and politic, constituting a public benefit corporation of the State. The Authority’s purposes, among others, are to develop and implement new energy technologies consistent with economic, social and environmental objectives, to develop and encourage energy conservation technologies, and to promote, develop, encourage and assist special energy projects. Borrower is a regulated electric and gas utility company located in State.

In Year 1 and Year 2, the Authority issued bonds (the “Prior Bonds”), the proceeds of which were lent to Borrower to finance, in part, facilities used in connection with Units A

and B at the Plant (the "Project Facilities"). The Project Facilities, which primarily consist of pollution control facilities, were financed and installed for the sole purpose of ensuring Borrower's compliance with air quality standards, regulations and water permits promulgated by State and Federal governmental agencies. In Year 3 and Year 4, the Authority issued the Bonds, pursuant to § 1313(a) of the Tax Reform Act of 1986 ("the 1986 Tax Act"), 1986-3 (Vol. 1) C.B. 1, 578, to refund the Prior Bonds.

In Year 5, Borrower agreed to sell the Plant to Purchaser. The sale was completed in Year 6. Notwithstanding the sale of the Plant, the Bonds remained outstanding and Borrower continues to be the conduit borrower with respect to the Bonds.

In Year 7, Purchaser entered into the Consent Decree with the State. The Consent Decree concerned claims that the operation of the Plant had resulted in certain violations of Federal and State environmental laws. Among other stipulations, the Consent Decree required, with respect to Unit A, that the purchaser install various pollution control systems if such unit were to continue in operation, and with respect to Unit B, that the Purchaser convert such unit to a gas-fired boiler or install various pollution control systems if such unit were to continue in operation.

Purchaser determined that the actions specified in the Consent Decree were not economical and, in Month 1, discontinued operations at Unit A, and then, in Month 2, at Unit B. Shortly after the discontinuation of operations at Unit B, Purchaser concluded that the continued "mothballing" of the Plant, including the Project Facilities, was not warranted and proceeded to contract for its demolition. As a result of the demolition, the Project Facilities will not be susceptible of any use, except perhaps as scrap materials for recycling. Under the demolition contract, there will be no net scrap value of the Project Facilities.

LAW

Section 1313(a)(1) of the 1986 Tax Act provides that, except as provided in § 1313(a)(3), the amendments made by § 1301 (relating to state and local bonds) shall not apply to any bond the proceeds of which are used exclusively to refund (other than to advance refund) a qualified bond (or a bond which is part of a series of refundings of a qualified bond) if (A) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and (B)(i) the average maturity of the issue of which the refunding bonds is a part does not exceed 120 percent of the average reasonably expected life of the facilities being financed with the proceeds of such issue, or (ii) the refunding bond has a maturity date not later than the date which is 17 years after the date on which the qualified bond was issued.

Section 1313(a)(3) of the 1986 Tax Act provides, in part, that § 150(b) of the 1986 Code shall be treated as included in § 103 of the 1954 Code and shall apply to refunding

bonds described in § 1313(a)(1) of the 1986 Tax Act.

Section 103(a)(1) of the 1954 Code provides that gross income does not include interest on the obligations of a State, a territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia.

Section 103(b)(1) of the 1954 Code provides, except as otherwise provided in § 103(b), any industrial development bond shall be treated as an obligation not described in § 103(a)(1) or (2). Section 103(b)(4)(F) provides that § 103(b)(1) shall not apply to any obligation which is issued as part of an issue substantially all of the proceeds of which are to be used to provide air or water pollution control facilities. A similar rule is contained in § 103(b)(4)(E) with respect to sewage and solid waste disposal facilities.

Section 150(b)(4) of the 1986 Code provides, in the case of any facility with respect to which financing is provided from the proceeds of any private activity bond which, when issued, purposed to be a tax-exempt facility bond described in § 142(a) (other than § 142(a)(7)), if such facility is not used for a purpose for which a tax-exempt bond could be issued on the date of such issue, no deduction shall be allowed for interest on such financing which accrues during the period beginning on the date such facility is not so used and ending on the date such facility is so used.

ANALYSIS

The guidance addressing changes in use or failure to properly use proceeds that is currently in effect does not apply to the Bonds. Sections 1.142-4 and 1.150-4 of the Income Tax Regulations apply to bonds issued on or after May 16, 1997. Issuers may apply these regulations to bonds outstanding on May 16, 1997, but must apply these in conjunction with §§ 1.142-0 through 1.142-2, 1.144-0 through 1.144-2, and 1.147 through 1.147-2. The Bonds were issued prior to May 16, 1997, and were issued pursuant to § 1313(a)(1) of the 1986 Tax Act. Therefore, the rules interpreting § 103 of the 1954 Code, not § 142 of the 1986 Code, apply to the Bonds.

T.D. 8712, which promulgated the final regulations that included §§ 1.142-4 and 1.150-4, obsoleted Rev. Proc. 93-17, 1993-1 C.B. 507, for actions that occur on or after May 16, 1997. Rev. Proc. 93-17 set forth conditions under which changes in the use of proceeds of an issue of state or local bonds would not result in those bonds being treated as violating certain requirements of §§ 141 through 150 of the 1986 Code and corresponding provisions of the 1954 Code. Rev. Proc. 93-17 was effective for any change of use of a bond-financed facility that occurred after March 8, 1993. But for T.D. 8712, this guidance would have applied to the Bonds.

Although neither the private activity bond regulations nor Rev. Proc. 93-17 control in this case, they provide useful guidance.

Under Rev. Proc 93-17, a change of use meant 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 to a different use. Only a change from a qualified use to a nonqualified use triggered the need for remedial action to preserve the excludability of the interest on the bonds.

Under § 1.142-2(d)(2), for net proceeds that are spent, a failure to properly use proceeds occurs on the date on which an action is taken that causes the bonds not to be used for the qualifying purpose for which the bonds were issued. For an issuer to avail itself of the remedial action provisions under § 1.142-2, the issuer must have reasonably expected on the issue date that 95 percent of the net proceeds of the issue would be used to provide an exempt facility and for no other purpose for the entire term of the bonds.

Thus both Rev. Proc 93-17 and § 1.142-2, in the case where proceeds have been spent, require a threshold inquiry as to whether the proceeds will be put to a use different from that for which the bonds were issued. In this case, the Consent Decree provides clear evidence that the Project Facilities, without any action on the part of the Authority or Purchaser, could no longer function in the manner expected when the Bonds were issued. Demolition of the Project Facilities, although an action, precludes any further use of the Project Facilities by causing them to change from what is currently an unexpected, non-functional use to no use at all except potentially as scrap materials for recycling. This is not a change of use within the meaning of the above described provisions.

CONCLUSIONS

Based on the facts described above, we conclude that the demolition of the Project Facilities will not (1) cause the interest on the Bonds to fail to be excludable from gross income under § 103 of the 1954 Code nor (2) cause § 150(b) of the 1986 Code to apply, precluding Borrower from deducting interest on the financing agreements relating to the Bonds.

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.

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. In particular, we express no opinion as to whether the interest on the Bonds is excludable under § 103, whether the interest on the financing agreements is otherwise deductible by Borrower, or whether the Bonds meet the requirements of § 1313(a)(1) of the 1986 Tax Act.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the 1986 Code provides that it may not be used or cited as precedent.

Sincerely,

Associate Chief Counsel
Financial Institutions & Products

By _____
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Branch 5